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SLOTTING FEES: ARE FAMILY FARMERS BATTLING TO STAY ON THE FARM AND IN THE GROCERY STORE?

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

ONE HUNDRED SIXTH CONGRESS

SECOND SESSION

SEPTEMBER 14, 2000

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COMMITTEE ON SMALL BUSINESS

ONE HUNDRED SIXTH CONGRESS

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SLOTTING FEES: ARE FAMILY FARMERS BATTLING TO STAY ON THE FARM AND IN THE GROCERY STORE?

THURSDAY, SEPTEMBER 14, 2000

UNITED STATES SENATE,
COMMITTEE ON SMALL BUSINESS,
Washington, D.C.

The Committee met, pursuant to notice, at 1:10 p.m., in room 628, Dirksen Senate Office Building, the Honorable Christopher S. Bond (Chairman of the Committee) presiding.

Present: Senators Bond, Burns and Kerry.

OPENING STATEMENT OF THE HONORABLE CHRISTOPHER S. BOND, CHAIRMAN, COMMITTEE ON SMALL BUSINESS, AND A UNITED STATES SENATOR FROM MISSOURI

Chairman BOND. Good afternoon. The hearing of the Small Business Committee will come to order.

I have to apologize. For those of you who are familiar with the way the Senate works you will realize that Murphy was an optimist when he propounded Murphy's Law. We have just had a vote that started a few minutes ago. That is why I am late. Several other of my colleagues are tied up in votes. We also have Floor debates and other activities going on, but I thought it was important that we get started on this extremely significant hearing. I want to thank everybody who has come today, witnesses and those who came just to learn more about it.

One year ago today the Small Business Committee held its first hearing on the use of slotting allowances by the retail industry and the impact that that has on small manufacturers. That hearing came about because of complaints expressed to my Ranking Member, Senator Kerry, and me from small manufacturers. I am pleased that we have worked on this problem in a bipartisan manner.

Since that first hearing, the Committee continued investigating this practice and, at the Committee's request, several Government agencies initiated efforts to take a closer look at slotting allowances and the impact of these fees on competition.

This afternoon the Committee will continue reviewing what we have learned about this issue within the last year, what remains to be examined, and the steps Congress and Federal agencies should now take, among other things, to gain a better understanding of slotting fees.

Additionally, this hearing will address produce farmers being compelled to pay slotting allowances and similar fees. Many small produce farmers and the associations representing them contacted the Committee to express their grave concern about the type of fees contributing to the downfall of America's small family farms.

As we will hear today, small farmers receive only a small fraction of the price consumers pay for produce. When farmers are also required to pay up-front fees or provide free merchandise to retailers to stock their produce, it becomes significantly more difficult for farmers to make a profit and continue to farm. We will hear today about these types of retail practices and what they mean for small farmers and consumers.

The Small Business Committee began looking at the issue of slotting in response to numerous complaints, as I said, received from small businesses about what appears to be a fundamentally unfair and perhaps unlawful retail practice which has continued to be concealed not only from the eyes of Congress and the agencies but from consumers and the public at large.

There are many definitions about what a slotting fee is, but most agree that slotting fees generally take the form of up-front payments of cash or product from a manufacturer to a retailer in exchange for the retailer stocking the manufacturer's products. Through the Committee's investigation hearing last year, we learned that large-chain retailers routinely demand substantial up-front slotting payments from manufacturers to get products on the shelf or to keep them on the shelf. We are talking about the most expensive real estate in America.

Chain retailers often exclude the products of small businesses simply because they cannot afford the excessive payments. Retailers frequently ignore the quality of a manufacturer's product when determining who gets on and who stays on the shelf. Whether a product is available to shoppers may depend solely on how much the manufacturer is willing to pay the retailer.

During its investigation the Committee has heard countless theories and anecdotes about what these fees are, how retailers request the fees from manufacturers, how they are treated for tax purposes and how these fees harm consumers through increased prices and decreased consumer choice and innovation. In order to make informed policy decisions about this issue Congress needs to get the full picture of what is occurring in the marketplace. To truly know when these fees are acting as an anti-competitive force, Congress and relevant Federal agencies must be able to compile the facts about how much retailers collect, how the fees are negotiated, and for what the fees are used. Acquiring this data, however, has been almost close to impossible.

It seems that these fees are the "dirty little secret" in retailing. Often nothing is in writing between the manufacturer and the retailer, and the amount of money paid in slotting fees is usually known only to supermarkets, their brokers and distributors.

In addition, most small manufacturers have expressed considerable fear of retribution from chain retailers for valid reasons and we have heard too many instances where someone complaining about slotting fees has been totally excluded from the market. Anybody who complains about the fees publicly, even anonymously, if they are discovered, gets dealt with.

Following the hearing last year this Committee requested the GAO to conduct a study on the use of slotting fees and other related fees in the retail grocery industry. We asked the GAO to collect the basic information on the types of fees being charged, the amounts, how manufacturers and retailers account for the fees, whether the fees are the same for everyone, the manner in which retailers demand such fees and the existence of the fees in other retail environments. Unfortunately, the GAO, despite its best efforts, could not satisfy this request.

Now we think the Small Business Committee has been very patient and we worked with both the retail industry and food manufacturers for the last year. We tried to get the industry to disclose data on slotting fees voluntarily. Unfortunately, these efforts have been futile.

Committee staff has expressed that frustration by drafting possible language to require disclosure on an annual basis of these fees. Unfortunately, the industry representatives were unable to appear today to answer questions about it to justify the process and we are going to be asking them some questions about it and asking them why we should not take steps to assure that these fees are disclosed to competitors and to consumers.

The Federal Trade Commission has been focusing on slotting fees. They held a workshop in May to address the legal issues surrounding the practice and we appreciate the FTC's work. The FTC has told us they cannot address the workshop findings until a final report has been considered by the Commission. Therefore, the staff is not participating today. We appreciate their cooperation and interest and I have undertaken an initiative to include in the FTC's budget $900,000 in the Commerce, Justice, State appropriations bill to examine the anti-competitive effects of slotting fees and possible remedies. The Committee intends to follow-up with the FTC to make sure that the Federal Government gets a full and complete picture and deals with any abuses they find.

One disturbing issue that arose in the workshop was the phenomenon that retailers charge up-front fees for small fruit and vegetable growers just to get their products on the shelf. The Committee had heard from other farmers about these unsavory practices.

At the hearing last year, representatives of the industry said the reason they have to charge fees is to mitigate the risk of putting new products on the market. Well, when you are talking about a product like this, a tomato, or like this, an orange, there is not a lot of risk. When I go into the supermarket to buy citrus fruit or a tomato, I am going to buy the best looking, best quality I see on the shelf.

You do not need a slotting fee to convince somebody that they need to buy tomatoes. That is usually on my shopping list when I go to the grocery store. In any event, these are not new products, and accordingly, the Committee decided it was appropriate to hear about why fees are requested from the produce industry and what they mean for the small farmer.

[The prepared statement of Senator Bond follows:]

SENATOR CHRISTOPHER S. BOND, Chairman
Committee on Small Business
Introductory Statement
"Slotting Fees: Are Family Farmers Battling to Stay on the Farm and in the Grocery Store?"
September 14, 2000

Good afternoon. One year ago today, the Small Business Committee held its first hearing on the use of slotting allowances by the retail industry and its impact on small manufacturers. That hearing came about from complaints expressed both to me and Senator Kerry from small manufacturers and I am pleased that we have worked on this issue in a very bipartisan manner. Since that first hearing, the Committee continued investigating this practice and, at the Committee's request, several government agencies initiated efforts to take a closer look at slotting allowances and the impact of these fees on competition. This afternoon, the Committee will continue reviewing what we have learned about this issue within the last year, what remains to be examined, and the steps Congress and Federal agencies should now take to, among other things, gain a better understanding of slotting fees.

Additionally, this hearing will address produce farmers being compelled to pay slotting allowances and similar fees. Many small produce farmers, and the associations that represent them, contacted the Committee to express their grave concern that these types of fees are contributing to the downfall of America's small family farms. As we will hear today, small farmers receive only a small fraction of the price consumers pay for produce. When farmers are also required to pay up-front fees or provide free merchandise to retailers to stock their produce, it becomes significantly more difficult for farmers to make a profit and continue to farm. We will hear today about what these types of retail practices mean for small farmers and consumers.

The Small Business Committee began looking at the issue of slotting fees in response to numerous complaints the Committee received from small businesses about what appears to be a fundamentally unfair retail practice -- and a practice that has continued to be concealed from the eyes of Congress, agencies and consumers. While many definitions abound of what a "slotting fee" is, most agree that slotting fees typically take the form of up-front payments of cash or product from a manufacturer to a retailer in exchange for the retailer stocking the manufacturer's products.

Through the Committee's investigation and the hearing last year, the Committee learned that large chain retailers routinely demand substantial up-front slotting payments from manufacturers to get products on the shelf or to keep them on the shelf. We're talking about the most expensive real estate in America. Chain retailers often exclude the products of small businesses simply because they cannot afford the excessive payments. Retailers frequently ignore the quality of a manufacturer's product when determining who gets on and stays on the shelf. Whether a product is available to shoppers may depend solely on how much the manufacturer is willing to pay.

During its investigation, the Committee has heard countless theories and anecdotes about what these fees are, how they are requested from manufacturers, how they are treated for tax purposes and how these fees harm consumers, through increased prices and decreased consumer choice and innovation. In order to make important policy decisions about this issue, Congress needs to get the full picture of what is occurring in the marketplace. To truly know when these fees are acting as an anti-competitive force, Congress and the relevant Federal agencies must be able to collect the facts about how much retailers collect, how the fees are negotiated, and for what the fees are used. Acquiring this data, however, has been impossible.

These fees are the "dirty little secret" of the retail industry. Often nothing is in writing between the manufacturer and the retailer, and the amount of money paid in slotting fees is usually known only to the supermarkets, their brokers and distributors. In addition, most small manufacturers have expressed considerable fear of retribution -- for valid reasons from what I've heard -- from chain retailers and dominant manufacturers if they speak publicly or even anonymously about slotting fees.

Following the hearing last year, the Committee requested the General Accounting Office to conduct a study on the use of the slotting fees and other related fees in the retail grocery industry. We asked the GAO to collect the basics -- information on the types of fees being charged, the amounts, how manufacturers and retailers account for such fees, whether the fees are the same for everyone, the manner in which retailers demand such fees and the existence of the fees in other retail environments. Unfortunately, the GAO, despite its best efforts, did not satisfy this request.

The Small Business Committee has been very patient. The Small Business Committee has been understanding with both the retail industry and food manufacturers for the last year. The Small Business Committee worked with them to get them to disclose data on slotting fees voluntarily. Unfortunately, these efforts have been futile. Therefore, the Committee drafted legislation to require the industry to disclose the data on an annual basis to the FTC and others. This is a similar response to what Congress enacted to combat "payola" in the record industry.

Unfortunately, the Food Marketing Institute stated that it was *unable* to appear today to address this situation. We have questions for the record for FMI, including one asking them for a good reason for why we should not legislatively require disclosure of this data. We will eagerly await their response.

As a result of the hearing last year, the Federal Trade Commission has also been focusing on slotting fees. The Commission held a workshop in May to address the legal issues surrounding this practice. That workshop provided a useful forum for many small manufacturers to testify about how such fees impaired their ability to do business, and the Committee is hopeful that the FTC's renewed interest in this issue will lead it to analyze thoroughly this practice.

The FTC is not here today as we have been told that they cannot address the workshop findings until a final report has been considered by the Commission. Therefore, FTC staff indicated that they could not divulge any new information.

The Committee greatly appreciates the FTC's cooperation and interest in the anti-competitive effects of slotting fees. That is why I took the initiative to have the FTC's budget increased by $900,000 in the Commerce-Justice-State appropriations bill. These funds are to be used to examine the anti-competitive effects of slotting fees.

So that this practice can be halted when the fees are bad for consumers and for small competitors, it is imperative that the FTC acquire information about what effect these fees have in the real world. The Committee will follow-up with the FTC after this hearing to receive assurances that it will take this important step with the new money being provided the Commission. It would be irresponsible for the Federal government to allow this practice to continue without a full and complete understanding about its effects on small businesses.

One disturbing issue that arose in the FTC workshop was the phenomenon of retailers charging up-front fees from small fruit and vegetable growers to get their products on the shelf and to keep them on the shelf. Through its own investigation, the Committee also heard from small farmers that retailers have been engaging in other unsavory practices, including requiring free produce in order to pay for the opening of new stores or warehouses. In other words, when Retailer X opens a new grocery store, it will request free product to stock the shelves of that store.

At the hearing last year, the primary rationale cited by the Food Marketing Institute for the charging of slotting fees was to mitigate the risk to retailers from new product introductions. Tomatoes, cucumbers and watermelons are not new products that would require a retailer to hedge its bets against these products finding a niche in the marketplace. Accordingly, the Committee decided it was appropriate to hear about why these fees are being requested and what they mean for the small farmer. Our first panel of witnesses represents almost 90 percent of the companies and farmers in this country who supply fresh fruit and vegetables to the global marketplace and they will address these issues.

The second panel includes the Administrator of the Economic Research Service of the Department of Agriculture. The ERS conducted a survey of retail practices in the produce industry and its Administrator will discuss the preliminary results of their study. The GAO will also testify on the second panel about their unsuccessful efforts to collect data on slotting fees and their results. Rounding out the second panel will be a distinguished academic, Professor Gregory Gundlach, who will speak on the status of research on slotting allowances and the evolving theories on the effect this practice has on consumers and competition. Professor Gundlach will also speak to why it is important for the Federal government to receive data on slotting fees.

Chairman BOND. Our first panel, and I invite them to come forward, are witnesses representing almost 90 percent of the companies and farmers in this country who supply fresh fruits and vegetables. They will address that issue.

The second panel includes the Administrator of Economic Research Service of the Department of Agriculture. The GAO will testify on the second panel about their unsuccessful efforts. And rounding out the second panel will be a distinguished academic, Professor Gregory Gundlach, who will speak on the status of research on slotting allowances and the evolving theories on the effect this practice has on consumers and competition, and why it is important for the Federal Government to receive data on slotting fees.

We begin the hearing by welcoming Thomas Stenzel, president of United Fresh Fruit and Vegetable Association; David L. Moore, president of the Western Growers Association; and Michael Stuart, president of the Florida Fruit & Vegetable Association.

Welcome, gentlemen. We look forward to your testimony. We will begin with Mr. Stenzel.

STATEMENT OF THOMAS E. STENZEL, PRESIDENT AND CEO, UNITED FRESH FRUIT AND VEGETABLE ASSOCIATION, ALEXANDRIA, VIRGINIA

Mr. STENZEL. Good afternoon, Mr. Chairman. Thank you very much for having us at this hearing.

United Fresh Fruit and Vegetable Association is a not-for-profit trade association representing the producers, distributors and marketers of fresh produce in the United States, working together with many our colleagues around the country representing regional associations and also working with our retail and food service customers. Our members range from the smallest family businesses to the largest multinational produce growers and marketers.

I am pleased to testify today on an important issue to consumers and to our industry and congratulate the Committee for its attention to this issue. Our industry is committed to providing Americans with a wholesome and abundant supply of fresh fruits and vegetables at the lowest possible cost, and that goal will be paramount in my testimony.

Food retailing, distribution, processing and production are experiencing today greater change and consolidation than at anytime in history. Companies are responding to marketplace forces to seek greater efficiencies that better serve the ultimate consumer. Yet, at the same time pressures to compete in this environment are sometimes leading buyers and sellers of produce to become adversaries rather than partners and often to the detriment of consumers.

Now our industry strongly believes in a free market in which produce suppliers and food retailers share the common goal of serving the consumer. The Perishable Agricultural Commodities Act assures fair trading standards for fresh produce in the United States. And we are ever vigilant in seeing that the Department of Agriculture enforces this extremely effective law. Yet, congressional oversight is needed in today's rapidly changing marketplace. The Federal Trade Commission, the Department of Justice, and the U.S. Department of Agriculture all have an obligation to understand the changing business dynamics in the food delivery system and to ensure that marketplace trade practices do not become marketplace abuses of power.

In recent years, a number of trade practices more familiar in the dry grocery area have become familiar to produce companies. Beginning within the last decade and the growth of packaged salads in the produce department, we have often seen requests for slotting fees and similar payments in order to do business.

Now perhaps we were naive not to anticipate this, but many produce growers simply had no experience with packaged foods and were taken aback. It just somehow did not seem fair to have to buy shelf space rather than simply offer your best price and the best quality and let the chips fall where they may.

We are not so naive today, and our larger challenge is the seemingly growing appetite for side deals, slotting fees, rebates, allowances, promotional fees, and all sorts of charges ranging from warehouse construction to store remodeling that are not contained in contracts, do not appear on invoices, and are otherwise unaccounted for in transactions.

As this Committee and the Federal agencies involved evaluate the topic of slotting fees, I urge you to look with broad perspective at the impact of all of these types of off-invoice fees and not be constrained by a more narrow definition of slotting.

Our industry's concern about slotting fees and these off-invoice payments is based on several factors. First, we believe that consumer choice and access to produce will be reduced. Let me emphasize that I do not just refer to the up-front slotting fees. Today, produce companies are being asked by some retailers, not all, to pay numerous off-invoice fees unrelated to the actual product costs. These rebates and allowances are sometimes tied to promotions or advertising which can serve consumers and growers alike. But in many cases they are more likely to be unrelated to any particular incentives or performance. Because of its charter, this Committee will naturally be concerned that small- to medium-sized growers are particularly vulnerable to these demands, but even the very largest produce companies are concerned about these practices.

Certainly we are concerned about fairness to our industry, but in some cases these fees paid in advance can leave a retailer with very little incentive to move more produce volume if their profit is tied to buying the produce rather than selling it to you as a consumer. That raises serious questions about public health as well, as government authorities tell us the simple step of eating at least five servings of fruits and vegetables a day is critical in preventing cancer, heart disease and other chronic diseases. The soaring cost to public health of artificially high-priced fresh fruits and vegetables should be a serious national concern.

Let me address the issue of transparency in how these trading practices work. Mr. Chairman, you are to be commended for helping to bring these issues out of the closet. The bright lights of this hearing room are having their effect. I am pleased to say that through your efforts, the reviews by the Federal Trade Commission are having some beneficial effects in the industry. We hear from our members that perhaps there is some dampening of the most egregious abuses that we have heard reported.

To that point, transparency and knowledge of industry practices will help everyone in produce marketing whether they are a grower or a retailer. In this mysterious world of off-invoice fees, suspicion grows and trust cannot flourish. Competitors battle ghosts rather than respond to true economic incentives. Many times we have found retail buyers who ask for fees simply because they are afraid their competitor is and they do not know what is being done anymore than the growers do.

Our organization does not believe this is simply a battle between produce buyers and sellers, but is rather a wake-up call for the entire fresh food production chain to better understand the cost and the values of delivering produce to American consumers. Basic business economics will prevail in an environment in which these transactions are not cloaked in mystery, but are negotiated openly, displayed on invoices, with specific performance requirements.

Finally, let me mention a slightly different concern. Traditional antitrust concerns have focused on regulating manufacturers' behavior to ensure fair competition, rather than focusing on the powerful buying groups. Frankly, we are concerned today that produce growers may be at greater risk than their customers who demand some of these payments. There is great dissension within the retail supermarket industry today. Many independent grocers feel that they may not be offered the same deals as some other chains get and they are madder than heck and say they are not going to take it anymore either.

Under the Robinson-Patman Act, sellers of products are required to offer the same terms to all competitive customers. When one retailer demands a special up-front deal to do business, a grower is placed in a difficult position. What from one side looks like a demanded concession may look like "special terms" to competing customers in a given market. As an observer of the stresses in food retailing today I see a real risk that grocers who imagine they are not getting the same deal as other retailers may be more likely to take action against the growers under these antitrust laws.

In addition, as produce suppliers begin to adapt to the marketplace size of their retail customers, we again face the risk of litigation if we even discuss slotting practices among suppliers. Let me say that my association and our industry fully comply with antitrust laws regarding pricing. But we also believe that many of the demands currently made in the marketplace should not be considered part of price negotiations, as they are off-invoice matters unrelated to the sale of any lot of produce. In these cases, we believe Congress and the regulatory agencies should specifically recognize and protect the ability of produce suppliers to discuss such practices openly, without regard to antitrust concerns about price setting.

I would call your attention to one exhibit here today, the example on the chart to my right of a request for a warehouse stocking charge. In this case produce suppliers fear even talking about whether they would agree to pay such a demand. And yet, this is clearly a case in which we believe that suppliers should be able to simply look at that demand; say it does not make sense; we do not want to pay it. Under antitrust laws we have great fear about retribution in terms of price setting from suppliers discussing whether to pay these fees.

[The chart follows:]

NEW STOCKTON WAREHOUSE OPENING PROGRAM

PART 1

1. ALL PURCHASE ORDERS FOR THE INITIAL FOUR WEEK FILL PERIOD WILL BEAR THE PAYMENT TERMS "2% 60, NET 61" FOR DISCOUNT VENDORS; "NET 60 DAYS" FOR NET VENDORS.
2. NO PALLET CHARGE OR EXCHANGE WILL BE REQUIRED DURING THIS FILL PERIOD.
3. 30 DAY FLOOR STOCK PROTECTION WILL BE PROVIDED FOR ANY PROMOTIONS BEGINNING WITHIN THE FIRST 30 DAYS OF STORE SHIPMENTS.

PART II

VENDORS MAY ELECT ONE OF THE FOLLOWING OPTIONS BY SUBMITTING THIS SIGNED FORM TO RALPHS GROCERY CO, ATT: CORPORATE PROCUREMENT DEPT. ATTN: DONNA GONYER, BY 11/24/99.

_____ 1. MINIMUM 10% INCREMENTAL STOCKING ALLOWANCE FOR A FLEXIBLE FOUR WEEK PERIOD TO BE SPECIFIED ON PURCHASE ORDERS;

_____ 2. FIFTY(50) CASES PER ITEM AUTHORIZED DELIVERED AND INVOICED AT NO CHARGE.

_____ 3. CASH EQUIVALENT (VENDOR LIST) OF FIFTY(50) FREE CASES PER ITEM AUTHORZED TO BE DEDUCTED FROM INITIAL PURCHASE ORDERS. DEDUCTION WILL BE PROCESSED 12/3/99. THERE WILL BE NO REMEDIATION ONCE THE DEDUCTION IS PROCESSED.

IN THE EVENT NO RESPONSE AGREEING TO ONE OF THESE OPTIONS IS RECEIVED, OPTION 3 WILL BE THE PRESUMED METHOD OF PARTICIPATION. RESPONSE MUST BE RECEIVED 11/24/99. THERE WILL BE NO REMEDIATION ONCE THE OPTION 3 DEDUCTION IS PROCESSED.

COMPANY_____________________________VEND#_______________(List all)

ADDRESS____

REPRESENTATIVE_____________________________TITLE___________

In conclusion, today many growers are concerned with what they see in the marketplace. We recognize that many of the changes are going to require new ways of doing business, and that is true both for produce growers and our retail customers. We believe in effective free market solutions for both buyers and sellers to serve the ultimate consumer. But to find those solutions we think the changing nature of our food system must be addressed by all parties openly and constructively.

We appreciate the Committee's commitment to this process. Thank you, Mr. Chairman.

[The prepared statement of Mr. Stenzel follows:]

Thomas E. Stenzel
President and CEO
United Fresh Fruit and Vegetable Association
September 14, 2000

Good afternoon Mr. Chairman and members of the Committee. My name is Tom Stenzel and I am President of United Fresh Fruit and Vegetable Association (UFFVA).

UFFVA is a nonprofit association representing producers, distributors and marketers of fresh produce, working together with our retail and foodservice customers and allied suppliers. Our members range from the smallest family businesses to large multi-national produce growers and marketers. We conduct programs to assure the nutritional quality and safety of fresh fruits and vegetables, promote industry efficiency in producing and delivering our products to consumers, and sound public policy in the legislative and regulatory arena.

I am pleased to testify today on an important issue to consumers and to the food industry, and I congratulate the Committee on your attention to this issue. Our industry is committed to providing Americans with a wholesome and abundant supply of fresh fruits and vegetables at the lowest possible cost, and that goal will be paramount in my testimony.

Food retailing, distribution, processing and production are experiencing today greater change and consolidation than at anytime in history. Companies are responding to marketplace forces to seek greater efficiencies that better serve our ultimate customers – the American and world consumer. Yet, at the same time, pressures to compete in this new environment are sometimes leading buyers and sellers of produce to become adversaries rather than partners, often to the detriment of consumers.

Our industry strongly believes in a free market in which produce suppliers and food retailers share the common goal of serving the consumer. The Perishable Agricultural Commodities Act assures fair trading standards for fresh produce in the United States, and we are ever vigilant in seeing that the Department of Agriculture enforces this extremely effective law. We would be concerned about calls for new legislation that might impede our marketplace. Yet, Congressional oversight is needed to ensure that today's rapidly changing marketplace is functioning effectively. The Federal Trade Commission, the Department of Justice, and the U.S. Department of Agriculture all have an obligation to understand the changing business dynamics in food delivery today, and ensure that marketplace trade practices do not become marketplace abuses of power.

In recent years, a number of trade practices more familiar in the grocery products area have become familiar to produce companies. Beginning within the last decade, the growth of packaged salads competing for shelf space in retail produce departments was often accompanied by requests for slotting fees and similar payments in order to do business. Perhaps we were naïve not to anticipate this, but many produce growers simply had no experience with packaged processed foods and were taken aback. It somehow seemed wrong to have to buy shelf space, rather than simply offer your best price and best quality and let the chips fall where they may.

We're not so naïve today, and our larger challenge as in industry is the seemingly growing appetite for deals, slotting fees, rebates, allowances, promotional fees, and side charges for everything from warehouse construction to store remodeling that are not contained in contracts, invoices, or otherwise accounted for in some transactions. As this Committee and the federal agencies involved evaluate the topic of slotting fees, I urge you to look with broad perspective on the impact of all of these types of off-invoice fees, and not be constrained by a more narrow definition of slotting fees.

Our nation's antitrust laws and public policy are designed to protect consumer welfare. Your oversight therefore must first ask the question what impact do these marketing practices have on the consumer? How are prices affected? Consumer choice? And in the case of produce, how might consumer health be affected?

On these issues, our industry has requested the Department of Agriculture to conduct a study of produce marketing and retail trade practices to better answer these questions. Our members are concerned about new financial demands being made on them in the marketplace, at a time when farm prices for produce are at rock bottom, but consumer prices for produce seem at all-time highs. A lack of knowledge and transparency in the industry has thus far left the debate over slotting fees and other off-invoice payments as a contentious and too often emotional battle.

We commend the USDA Economic Research Service for launching a comprehensive study of these issues with regard to the produce sector, and we also commend the supermarket industry for participating in that study. We believe there must be a constructive and open dialogue on these issues, and we look forward to USDA's input on this topic.

Our industry's concern about slotting fees and off-invoice payments to secure business relationships is based on several factors. First, we believe that consumer choice and access to produce will be reduced. Let me emphasize that I don't only refer to fees for new product introductions, the traditional definition of slotting fees. Today, produce companies are being asked by some retailers to pay off-invoice fees -- unrelated to the actual product cost -- just to continue to do business. These rebates and allowances are sometimes tied to promotions, advertising and sampling programs, which can serve consumers and growers alike. But in some cases today, they are more likely to be unrelated to any incentives or performance. Because of its charter, this Committee will naturally be concerned that small to medium-sized growers are particularly vulnerable to these demands, but even the largest produce companies are concerned about such practices.

Certainly produce growers are concerned about fairness and the financial health of our industry, but in some cases, these off-invoice fees paid in advance can leave a retailer with little incentive to move more produce volume, if their profit is tied to *buying* produce rather than *selling* it. That raises serious questions about public health, as government authorities tell us the simple step of eating at least five servings of fruits and vegetables a day is critical in preventing cancer, heart disease and a host of other chronic diseases. This issue may be beyond the scope of this Committee, but I assure you that the soaring cost to public health of artificially high priced fresh fruits and vegetables should be a serious national concern.

Second, let me address the issue of transparency in how these trading practices work. Mr. Chairman, you are to be commended for helping bring many of these issues out of the closet. As with most controversial practices, whether in public agencies or private business, public notice has a great impact in dampening the most severe abuses. I am pleased to say that your efforts, and the reviews by the Federal Trade Commission and others, have already had beneficial effects. Our members report fewer demands for off invoice fees and payments than they had experienced even a year or two ago.

To that point, transparency and knowledge of industry practices will help everyone in produce marketing, whether grower, handler or retailer. In the mysterious world of off-invoice fees, suspicion grows and trust cannot flourish. Competitors battle ghosts rather than respond to true economic incentives that would reduce costs to consumers. Many times we have found retail buyers asking for fees simply because they are afraid their competitor is. And I suppose I don't blame them. Our organization does not believe this issue is a battle between produce buyers and sellers, but is rather a wake-up call for the entire fresh food production chain to better understand the cost of delivering produce to American consumers. Basic business economics will prevail in an environment in which these transactions are not cloaked in mystery, but are negotiated openly and displayed on invoices with specific performance requirements.

In the long run, comparable market power is the key to economic parity and a fair and competitive marketplace. Our industry does not hold the philosophy that big is bad. In fact, many large retailers refuse to ask for slotting fees and similar off-invoice payments for produce. These retailers have found greater success in focusing on consumer satisfaction to increase their own profitability. They put their focus on great merchandising and marketing of produce to consumers, not making their entire profit through side fees. Left to the free marketplace – and a more transparent marketplace -- we would like to think that these companies' success will ultimately rein in the worst abuses.

Finally, let me turn to a slightly different concern. Traditional antitrust concerns have focused on regulating manufacturers' behavior to ensure fair competition, rather than focusing on fair practices of powerful buying groups. Frankly, we are extremely concerned that the nation's antitrust laws may place produce growers at greater risk today than their customers who demand these payments. The dissension within the retail supermarket industry today is clear. Some independent grocers feel that they may not be offered the same deals that other chains get, and they're madder than heck and not going to take it anymore.

Under the Robinson-Patman Act, sellers of products are required to offer the same terms to all competitive customers. When one retailer demands a special up-front deal to do business, a grower of produce is placed in a difficult position. What, from one side, looks like a demanded concession, may look like "special terms" to competing customers in a given market. As an observer of the stresses in the food retailing arena today, I see a real risk that grocers who imagine they are not getting the same "deal" as other retailers may be more likely to take action against growers under antitrust laws. In this case, our industry needs the protection originally envisioned in these laws, rather than being seen as the cause of such practices.

In addition, as produce suppliers begin to adapt to the marketplace size of their retail customers, they again face the risk of litigation if they even discuss slotting fee practices with other suppliers. Let me say that my association and our industry fully comply with antitrust laws regarding pricing. But, we also believe that many of the financial demands currently made in the marketplace should not be considered price negotiations, as they are off-invoice matters unrelated to the sale of any lot of produce. In these cases, we believe Congress and the regulatory agencies should specifically recognize and protect the ability of produce suppliers to discuss such practices openly, without regard to antitrust concerns about price setting.

In conclusion, I would like to comment briefly on one key economic difference between the fresh fruit and vegetable industry and other food sectors. Our products are highly perishable and must be sold immediately after harvest or packing. Our products are priced according to classic supply and demand forces, and prices can change hour to hour. In this environment, produce is inherently different from other manufactured food products, which are most often sold off a list price.

Slotting fees, discounts and side payments that have become commonplace in dry grocery are simply not appropriate to fresh produce. Our growers cannot set arbitrary list prices for their commodities, then discount those prices to provide rebates and fees. Yet too often, that is what some buyers seem to expect. For the most part today, fruit and vegetable commodity prices are set at the economic equilibrium point every day by an efficient supply and demand market. If consumers demand more of a certain commodity, price goes up. If good growing conditions result in oversupply, prices go down. Our suppliers simply do not have the capability long-term of providing slotting fees and similar expenses under these market conditions.

We also recognize, however, that some business partners are choosing longer-term contracts and entering into marketing agreements with special funds for promotional allowances, price discounts, slotting, rebates and the like. Many of these agreements are in capital-intensive segments of our industry such as value-added fresh processing, where recovering the capital costs of production facilities is critical. Even in these cases, however, a much more transparent accounting of these fees would be appropriate and useful for all parties in the distribution chain.

Today, many growers throughout the country are concerned about what they see happening in the marketplace. Many of the changes will require new ways of doing business, and new ways of competing. We believe that's true for both produce growers and our retail customers, and that effective free market solutions for both buyers and sellers can best serve the ultimate consumer. To find those solutions, however, the changing nature of our food system must be addressed by all parties openly and constructively. We appreciate the Committee's commitment to this process.

# # #

Chairman BOND. Thank you very much, Mr. Stenzel.
Mr. Moore.

STATEMENT OF DAVID MOORE, PRESIDENT, WESTERN GROWERS ASSOCIATION, NEWPORT BEACH, CALIFORNIA

Mr. MOORE. Good afternoon, Mr. Chairman. My name is David Moore and I am a farmer and shipper of fresh produce in Bakersfield, California. I also serve as president of the Western Growers Association whose 3,500 members grow, pack and ship fresh fruits, vegetables and nuts in Arizona and California.

WGA appreciates the opportunity to testify before the Senate Committee on Small Business regarding the impacts of slotting fees and retail consolidation in the fresh produce industry. Today, small, medium and large farmers are battling like never before to remain economically viable. The proliferation of slotting fees and other anti-competitive business practices by the large supermarkets is a very real threat to family farmers. Congress and the Administration must take action to address this issue.

As retail consolidation continues, growers are seeing the use of slotting fees and other anti-competitive business practices expand. This is strong evidence which indicates that retail consolidation has gone too far.

It is important to note that retail consolidation in the fresh produce industry is producing anti-competitive practices which go beyond the use of traditional slotting fees. Over the past few years our growers have confronted the following practices or fees imposed by retailers: pay-to-play, pay-to-stay, these fees are appropriately named; rejection without reasonable cause of perishable commodities and violations of the Perishable Agricultural Commodities Act; computer/technology-related fee charges; off-invoice demands; advertising or promotional allowances; slotting fees; interview fees; category management fees; warehouse construction/new store opening fees; and indemnification and hold harmless agreements.

As an example, one retailer in California known as Ralphs/Food 4 Less Warehouse Stores demanded of grower/shipper suppliers a "new distributing facility opening fee." This effectively required monetary payment either in free product or direct payment to help underwrite the cost of construction of a new warehouse that was constructed to benefit the efficiency of the retailer. There is an all too subtle message that a refusal to pay-to-play or refusal to pay-to-stay can be the difference between the ability to sell or not sell to a particular retailer. I know of no other industry that is required to provide working capital for a customer's new distribution facility.

Another example, multiple large retailers have demanded food safety audits of grower/shipper farming operations by a third party auditor. The recommendation requires the utilization of a specific auditor recommended by the retailer and also the dissemination of one's information on a web site which incurs significant expenses for the grower/shipper. This demand allows for no reimbursement for the cost of this extra expense of validating practices that may have already been documented by the grower/shipper's own internal farming and good agricultural practices.

In another example, a prominent member has articulated that his business was "encouraged" by a dominant retailer to contribute $30,000 under the guise of a promotional allowance for a small ad for the commodity he was selling. The shipper was not assured that additional product would be purchased or that any long-term relationship would be maintained or that any priority for that shipper would be provided in supplying product to the retailer.

Most recently, our grower/shippers have been encouraged by one major retailer to prepare for participation in a new e-commerce venture for selling and buying perishable commodities. While these technological advancements which facilitate the communication, transmission of an entire transaction via computer will be beneficial to all in the distribution chain, in this case the fee assessed for each individual transaction, rather than being cost-shared by all parties involved, will be a grower/shipper obligation exclusively.

Finally, a retailer recently assessed a fee to help "support" the opening of a new warehouse facility. I am told that a supplier was assessed $2,000 per stock keeping unit which, depending on the number of produce items you may sell, can be tens of thousands of dollars that are unilaterally being deducted from the remittance by the retailer. Clearly, a unilateral institution of fees by the retailer constitutes a direct violation of the Perishable Agricultural Commodities Act (PACA).

Another disturbing practice our members are experiencing is the rejection, without reasonable cause of perishable commodities. Large retailers are rejecting produce and are arbitrarily refusing to comply with the terms of the contracts without giving any reason or opportunity for inspection. They just do not want it. This also is a flagrant violation of the PACA, and is a prime example of the dark side of excess retail consolidation in our industry.

These are just a few examples of the many types of off-invoice demands and other arrangements which have not traditionally been a part of the produce industry. In short, the balance of power between supplier and retailer has shifted dramatically in favor of the large chain supermarkets over the growers. The high degree of retail consolidation is providing the large retailers with the market muscle needed to squeeze small growers through anti-competitive practices.

Historically, the consumer would benefit from a surplus of a given fruit or vegetable commodity through lower prices. Today, however, declines in prices paid to growers are not being passed on to the consumer.

WGA maintains a web site (www.wga.com) which reports the price spread between the price paid to the grower and retail price charged to consumers. We have seen price spreads of 400 percent to 1000 percent and even higher for commodities such as iceberg lettuce, naval oranges, cauliflower. And if you will notice the chart over here, we handle probably 24 different items we have at all times on our web site but in the interest of time and clarity we just brought these three examples here. But you can see the spreads.

[The chart follows:]

EXAMPLES OF PRODUCE PRICE SPREADS

	Week Ending	Price Paid To Farmers	City	Retail Price	Price Spread
Iceberg Lettuce					
	March 31, 2000	$0.17	Atlanta	$1.24	629%
			Los Angeles	$0.99	482%
			New York	$1.34	688%
Navel Oranges					
	March 31, 2000	$0.08	Atlanta	$0.48	500%
			Los Angeles	$1.04	1,200%
			New York	$0.43	438%
Cauliflower					
	January 28, 2000	$0.17	Atlanta	$1.05	518%
			Los Angeles	$1.09	541%
			New York	$0.91	435%

I might just highlight the fact that we have had a disastrous year in the naval orange business because of overproduction and other things, which is our fault, no one else's but the price has not declined. It is a higher price this year than last year when the retailers were paying a much higher price to the shippers.

In many instances, wholesale prices have dropped without any corresponding decrease in the retail price. This is strong evidence that consumers are being adversely impacted when large retailers have the market power to keep prices high when wholesale prices paid to growers are declining. It is important to note that the price spreads of 400 percent to 1000 percent between shipper and retailer do not include any additional payments by the growers to retailers in the form of slotting fees, rebates, promotional allowances or other off-invoice fees.

Unchecked retail consolidation is also adversely impacting family farmers. The overriding trend is that growers are seeing strong downward pressure on wholesale prices and operating margins, while facing slotting fees and other new off-invoice payments. In essence, the small farmer is being squeezed by retailers who are getting larger and larger through consolidation, becoming totally dominant in their market.

The downward price pressure is felt most acutely by the smallest growers. Should this unhealthy trend continue, it will be difficult for many U.S. fruit and vegetable growers to maintain economic viability in markets dominated by large retail chain stores.

WGA believes that the adverse impacts of the unchecked retail consolidation on both growers and consumers demands serious and urgent attention by the Federal Government. To date, we have not seen an adequate response from the Federal Government on this urgent matter. WGA urges the appropriate Federal agencies to vigilantly enforce Federal antitrust laws to maintain healthy competition and prevent anti-competitive practices in our industry.

If the use of slotting fees and other off-invoice payments falls into a gray area of antitrust law, then Congress should amend the law to provide regulators with guidance in the area. The FTC should examine the feasibility of developing specific guidance to provide the foundation for acceptable or unacceptable demands by retailers.

Possibly the best way to promote vibrant and healthy competition in the fresh produce market is to prevent further retail consolidation in our industry. Another suggestion is to require the disclosure of slotting fees and off-invoice payments in the retailer's consolidated financial statements, such as the company's Form 10-K.

In closing, WGA believes that slotting fee practices and other anti-competitive practices are a serious problem that demands further congressional attention.

I thank you very much, Mr. Chairman.

[The prepared statement of Mr. Moore follows:]

Western Growers Association
Serving the California and Arizona Fresh Produce Industry

Statement of David Moore, President
Western Growers Association

Senate Committee on Small Business

September 14, 2000

Introduction

Good afternoon, Mr. Chairman. My name is David L. Moore, and I am a farmer in Bakersfield, California, and I serve as President of Western Growers Association ("WGA"), an agricultural trade association whose 3,500 members grow, pack, and ship 90% of the fresh vegetables and about 70% of the fresh fruit and nuts grown in Arizona and California. This constitutes more than one half of the nation's production of fresh produce.

WGA appreciates the opportunity to testify before the Senate Committee on Small Business at this hearing regarding the impacts of slotting fees and retail consolidation in the fresh produce industry. Today, small, medium and large family farmers who grow, pack and ship fresh fruits and vegetables are battling like never before to remain economically viable. The proliferation of slotting fees and other anti-competitive business practices by the large chain supermarkets is a very real threat to family farmers, and Congress and the Administration must take action to address this issue.

Marketing Impacts of Retail Consolidation

It is an established fact that there has been a great deal of consolidation within the U.S. retail supermarket industry in recent years. For example, in Southern California, only three large supermarket chains hold about two-thirds of the market. As retail consolidation continues, growers are seeing the use of slotting fees and other anti-competitive business practices expand exponentially. The extensive use of anti-competitive business practices is strong evidence which indicates that retail consolidation has gone too far. When large retail supermarkets wield an inordinate amount of market power, both family farmers and consumers are adversely impacted.

It is important to note that retail consolidation in the fresh produce industry is producing anti-competitive practices which go beyond the use of traditional slotting fees. Our growers have confronted the following types of practices or fees imposed by retailers in the past few years:

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- "Pay To Play" and "Pay to Stay" Fees;

- Rejection Without Reasonable Cause of Perishable Commodities and Violation of the Perishable Agricultural Commodities Act;

- Computer/Technology Related Fee Charges; Off-invoice Demands; Advertising and Promotional Allowances; Slotting Fees; Interview Fees; Category Management Fees; Warehouse Construction/New Store Opening Fees, and Indemnification/Hold Harmless Agreements.

Additionally, there are innovative and new practices that large retailers are demanding that our membership relays to us on a daily basis. For example, one retailer in California known as Ralphs/Food 4 Less Warehouse Stores demanded of grower/shipper suppliers a "new distribution facility opening fee." The retailer provided a variety of innovative methods to pay this fee, but it effectively required monetary payment either in free product, or a direct payment to help underwrite the cost of construction of a new warehouse that was constructed to benefit the efficiency of the retailer. There is an all too subtle message, in many of these cases, that a refusal to "pay to play," or refusal to "pay to stay," can be the difference between the ability to sell, or not sell, to particular retailers. It is remarkable that I know of no other industry that is required to provide working capital for a customer's new distribution facility.

As a way of further example, multiple large retailers have demanded food safety audits of grower/shippers' farming operations by a third party auditor. The recommendation requires, in many cases, utilization of a specific auditor recommended by the retailer, and also the dissemination of one's information on a website which incurs significant expenses for the grower/shipper. This demand allows for no reimbursement for the cost of this extra expense of validating practices that may have already been documented by the grower/shipper's own internal farming and good agricultural practices.

In another "pay to stay" example, a prominent member has articulated that his business was "encouraged," by a dominant retailer, to contribute $30,000, under the guise of a promotional allowance, for a one-inch by three-inch ad for the commodity he was selling. The irony of the demand is that the shipper was not assured that additional product would be purchased, or that any long term relationship would be maintained, or for that matter, any priority for that shipper would be provided in supplying product to the retailer.

Most recently, our grower/shippers have been encouraged by one major retailer to prepare for participation in a new e-commerce venture for the selling and buying of perishable commodities. While these technology advancements which facilitate the communicating and transmitting of an entire transaction via computer will be beneficial to all in the distribution chain, in this case the fee assessed for each individual transaction, rather than being cost-shared by all parties involved, will be an exclusive grower/shipper obligation exclusively.

Finally, a retailer recently assessed a fee to help "support" the opening of new warehouse facilities. I am told that a supplier was assessed $2,000 per stock keeping unit (sku), which, depending on the number of produce items you may sell, can be tens of thousands of dollars that are unilaterally being deducted from remittances by the retailer. Clearly, a unilateral institution of fees by this retailer constitutes a direct violation of the Perishable Agricultural Commodities Act (PACA).

Another disturbing practice our members are experiencing is the rejection, without reasonable cause, of perishable commodities. Large retailers are rejecting produce and are arbitrarily refusing to comply with the terms of contracts without giving any reason or opportunity for inspection - they just don't want it. This also is a flagrant violation of the PACA, and is a prime example of the dark side of excess retail consolidation in our industry.

These are just a few examples of the many types of off-invoice demands and other business arrangements which have not traditionally been a part of the produce industry, but are now being demanded of growers and shippers by large retailers. In short, the balance of power between supplier and retailer has shifted dramatically in recent years in favor of the large chain supermarket over the growers. As retailers get fewer and larger, growers do not have any choice in where they sell their fresh produce. We realize that, like many other industries, the development of new technology is changing the way business is done in the fresh produce industry. However, we strongly believe that the high degree of retail consolidation is providing the large chain retailers with the market muscle needed to squeeze small growers through anti-competitive practices which are thinly disguised as a new way of doing business.

Consumer Impacts of Retail Consolidation

Historically, the consumer would benefit from a surplus of a given fruit or vegetable commodity through lower prices. Wholesale prices would decrease, and the retail store would pass on the lower price to the consumer. Today, however, it is often the case that the large retail chain stores, rather than consumers, realize the price savings from any surplus situation by maintaining a significant price spread on produce.

WGA maintains a web site (www.WGA.com) which reports the price spread between the price paid to the grower and the retail price charged to consumers. In the recent past, we have seen price spreads of 400% to 1,000%, and even higher in some instances, charged to consumers for commodities such as iceberg lettuce, navel oranges and cauliflower. In many instances, wholesale prices have dropped without any corresponding decrease in the retail price. This is strong evidence that consumers are being adversely impacted when large retailers have the market power to keep prices high when wholesale prices paid to growers are declining.

It is important to note that the price spreads of 400% to 1,000% between shipper and retailer do **NOT** include any additional payments made by growers to retailers in the form of slotting fees, rebates, promotional allowances or other off-invoice fees. I think it is fair to pose the following question at this point: Do retailers who are charging spreads of 400% to 1,000%, and even higher in some cases, need to charge slotting or other off-invoice fees in order to remain economically viable? WGA doesn't think so. Rather, the fact that slotting fees are being layered on top of large price spreads is further evidence that retail consolidation is giving large retail chain stores too much market power. This situation adversely impacts consumers as well as growers.

A further point with regard to consumer impacts is that we are not talking about the market for a luxury item. An affordable supply of fresh fruits, vegetables and nuts is critically important to the maintenance of a healthy diet for all Americans. When declining wholesale prices are not passed on by the large retail chain stores, the health of all Americans, and in particular low income consumers, is diminished. I am aware that the Federal Trade Commission recently conducted an investigation of alleged price collusion by the major oil companies due to the recent increase in oil prices. WGA believes that retail consolidation in the fresh produce industry merits equal, if not greater, attention by the federal government given the fact that the quality of America's health is at stake.

Grower Impacts of Retail Consolidation

In addition to negatively impacting consumers, unchecked retail consolidation is also adversely impacting family farmers. The emergence of slotting fees in the fresh produce industry is just one manifestation of the power retailers wield due to retail consolidation. Other trends facing growers which can be attributed to too much retail consolidation are: overall downward pressure on prices paid to growers; decreased movement of produce volume; fewer markets for price sensitive commodities; erosion of payment terms; and demands for promotional fees without any clear link with a specific promotional effort.

The overriding trend is that growers are seeing strong downward pressure on wholesale prices and operating margins while facing slotting fees and other new off-invoice payments. In essence, the small farmer is being squeezed by retailers which are getting larger and larger through retail consolidation and dominating their markets. This downward pressure on prices paid to growers comes at a time when growers are seeing significant increases in their input costs. This downward price/rising cost pressure is felt most acutely by the smallest growers. Should this unhealthy trend continue, it will be difficult for many U.S. fruit and vegetable growers to maintain economic viability in markets dominated by large retail chain stores.

This is a very difficult problem for growers to address. With fewer and larger retailers, the cost of speaking out against anti-competitive practices can be extremely high. Growers have been reluctant to voice their concerns publicly out of the fear of angering their only customers. However, I would like to assure the committee that there is widespread concern regarding anti-competitive practices by large retailers among family farmers.

Possible Solutions

WGA believes that the adverse impacts of unchecked retail consolidation on both growers and consumers demands serious and urgent attention by the federal government. It is incumbent upon the appropriate federal authorities to closely scrutinize retail consolidation in order to ensure that fair and healthy competition is maintained in the market for fresh produce. Again, we are not talking about luxury items, but rather the availability of an affordable supply of fresh produce necessary to maintain a healthy diet. To date, WGA has not seen an adequate response from the federal government on this urgent matter.

WGA urges the appropriate federal agencies to vigilantly enforce all federal anti-trust laws in order to ensure that anti-competitive practices are not used by large retail chain stores against small fruit and vegetable growers. The issues being considered today are governed primarily by the Robinson-Patman Act. Like many laws, times have changed since its adoption, and perhaps the Act needs to be amended to enable regulators to address new problems which arise. If the use of slotting fees and other off-invoice payments falls into a gray area of anti-trust law, then Congress should consider amending the statute to provide regulators with guidance on slotting fees and other potentially anti-competitive practices. Moreover, possibly the best way to promote vibrant and healthy competition in the fresh produce market is to prevent further retail consolidation in our industry.

Another suggestion is to require the disclosure of slotting fees and other off-invoice payments in the retailers consolidated financial statements which must be submitted to the Securities and Exchange Commission. For example, they could be disclosed in the notes accompanying the company's Form 10-K. This would also benefit investors, who deserve to know the source of the corporation's income.

I understand that USDA's Economic Research Service is conducting a review of the impact of retail consolidation and trade practices in our industry, and also that the Federal Trade Commission has given some attention to this issue in recent months. FTC should examine the feasibility of developing specific guidance to provide the foundation of acceptable or unacceptable demands by retailers. WGA urges Congress and the federal agencies to expedite these reviews and implement solutions in a timely manner.

In closing, WGA believes that slotting fees and other anti-competitive practices are a serious problem that demands further Congressional attention. We appreciate your holding this hearing, and look forward to working with Congress and the federal agencies on this matter of great importance to family farmers and consumers alike. Thank you, Mr. Chairman.

Chairman BOND. Thank you very much, Mr. Moore.
Mr. Stuart.

STATEMENT OF MICHAEL J. STUART, PRESIDENT, FLORIDA FRUIT & VEGETABLE ASSOCIATION, ORLANDO, FLORIDA

Mr. STUART. Thank you very much, Mr. Chairman, and good afternoon. Florida Fruit & Vegetable Association is a grower organization that represents producers of fresh vegetables, citrus, tropical fruit and a variety of other commodities. Our members range in size from single-commodity growers of less than 100 acres to larger, highly diverse grower/shippers. A large portion of our membership is indeed family-based.

While the subject of today's hearing is obviously slotting fees, I think it is important to touch briefly on what we believe is really the root cause of all of this, and that is consolidation of the retail industry. According to The Food Institute Report, the five largest food retailers in the United States accounted for a whopping 40 percent of industry-wide sales of $271 billion in 1998 compared to 5 years earlier when it took the top 20 companies to reach the same percentage.

As supermarket chains in the United States become fewer and larger, these retail giants enjoy a considerable bargaining advantage over their suppliers. This is especially alarming for fresh fruit and vegetable growers, many of whom are, in fact, small- to medium-sized family businesses. As buying power concentrates within the retail grocery industry, fresh produce growers have fewer customers to whom they can sell their products. The net result is continued pressure to reduce prices paid to growers.

Unfortunately, consumers rarely see the benefit of these lower prices at the supermarket. For the past several years, the Florida Department of Agriculture and Consumer Services has conducted weekly surveys of average farm and food retail prices and major metropolitan areas around the State. The data generated by these surveys often show a wide disparity and a general lack of relationship between farm and retail prices for selected fruits and vegetables. When this happens, consumers get no relief at the marketplace and growers see no increased sales of their products.

In our opinion, it is not likely that U.S. consumers will ever benefit from the continued consolidation of food retailers in this country if consumers' experience in the United Kingdom is any indication. A 1998 study by the Office of Fair Trading in Great Britain, a country now dominated by four grocery retail chains, suggests that British retailers are increasingly able to retain the greater profits from their increased bargaining power rather than passing them onto consumers.

A November 17, 1998 article in Britain's International Express estimated that the average family in Britain pays over 1,000 pounds more a year for food than those on the European continent.

That brings us to the issue of slotting fees which is obviously the subject of today's hearing. In addition to these heightened pricing pressures, fruit and vegetable growers and shippers are increasingly being asked to provide payments such as up-front fees, allowances or rebates to retailers, ostensibly to support the marketing costs of the growers' crops. In reality, however, growers tell us that these pay-to-play or pay-to-stay payments rarely result in any visible benefits and may only serve to boost the profit margins for retailers. Many of these requests for payments come in the form of per package rebates that have no relation to product performance.

One request by a large retailer, it has been mentioned here a couple of times today, involved a per package contribution in order to fund the construction of its new produce distribution facility. So in addition to growers having to finance their own operations, they are also being asked to make direct payments to pay for capital improvements for the customers.

I think we all realize that slotting fees have been a mainstay in the dry goods section of retail supermarkets for many years. We would argue, however, that slotting fees have absolutely no place in the produce department of a supermarket. The highly perishable and seasonal nature of our industry makes that completely impractical. Because fruits and vegetables are priced-based on supply and demand forces, these are costs that cannot be passed along in the marketplace. The bottom line is that growers cannot recover the costs of these fees. Ultimately, the cost of this pay-to-play practice comes from growers' profit margins, which in today's environment are very slim and in some cases nonexistent.

In addition to slotting fees consolidation has resulted in other trade practices affecting growers. In recent years, retail buyers have put increasing pressure on growers to agree to terms outside regulations under the Perishable Agricultural Commodities Act. The net impact of this for a grower is not only the loss of the use of his money, but also the potential loss of his rights under the trust provisions of the law. In order to keep business, growers also report that they more frequently have to accept take-it-or-leave-it price adjustments on product after delivery, even though there are no defects that would warrant such a reduction.

Again, these are just but a few of the marketplace issues and trading practices that growers are facing in the marketplace. Believe me when I tell you that the scope and variety of these fees are only limited by the creativity of those requesting them.

Again, Mr. Chairman, we greatly appreciate your time, the Committee's time, and your staff's time in investigating this issue and we look forward to your questions.

[The prepared statement of Mr. Stuart follows:]

STATEMENT OF
FLORIDA FRUIT & VEGETABLE ASSOCIATION

BEFORE THE
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

HEARING ON
"SLOTTING FEES: ARE FAMILY FARMERS BATTLING
TO STAY ON THE FARM
AND IN THE GROCERY STORE?"

THURSDAY, SEPTEMBER 14, 2000

Michael J. Stuart
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Submitted September 12, 2000

STATEMENT OF
FLORIDA FRUIT & VEGETABLE ASSOCIATION

BEFORE THE
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

HEARING ON
"SLOTTING FEES: ARE FAMILY FARMERS BATTLING
TO STAY ON THE FARM
AND IN THE GROCERY STORE?"

Florida Fruit & Vegetable Association (FFVA) appreciates the opportunity to provide input to the Senate Small Business Committee in its review of slotting fees and other issues faced by farmers selling their products in today's marketplace. FFVA is an organization that represents growers of fruits, vegetables, and other crops. Its members range in size from single-commodity growers of less than 100 acres to larger, highly diverse grower/shippers. A large portion of our membership is family-based.

FFVA members are deeply concerned about the consolidation of retail food marketers in the United States, and the impact of this consolidation on those who supply fruits and vegetables to these mega-retailers. According to The Food Institute Report, the five largest food retailers in the United States accounted for a whopping 40% of industry-wide sales of $270.7 billion in 1998 compared to five years earlier, when it took the top 20 companies to reach the same percentage.

As supermarket chains in the United States become fewer and larger, these retail giants enjoy a considerable bargaining advantage over their suppliers. This is especially alarming for fresh fruit and vegetable growers - many of whom are small to medium sized family businesses. As buying power concentrates within the retail grocery industry, fresh produce growers have fewer customers to whom they can sell their highly perishable and price sensitive commodities. The net result is continued pressure to reduce prices paid to growers. This comes at a time when growers are already facing depressed prices as a result of increased global competition.

Unfortunately, consumers rarely see the benefit of these lower producer prices at the supermarket. For the past several years, the Florida Department of Agriculture and Consumer Services (FDACS) has conducted weekly surveys of average farm and food retail prices in major metropolitan areas in the state. The data generated by these surveys often show a wide disparity and a general lack of relationship between farm and retail prices for selected fruit and vegetable commodities. When this happens, consumers get no relief at the supermarket, and growers see no increased sales of their products.

If consumers' experience in the United Kingdom is any indication, it's not likely that U.S. consumers will ever benefit from the continued consolidation of food retailers in this country. A 1998 study by the Office of Fair Trading in Great Britain, a country now dominated by four grocery chains, suggests that British retailers are increasingly able to retain the greater profits from their increased bargaining power rather than passing them to consumers. More specifically, a November 17, 1998, article in Britain's International Express estimated that the average family in Britain pays over £1,000 more a year for food than those on the European continent. An article in the December 14, 1998, issue of Forbes cited profit figures for Britain's four largest chains - profits that were 50 percent higher that U.S. grocery chains.

In addition to heightened pricing pressures, fruit and vegetable growers and shippers are increasingly being asked to provide trade promotion payments such as allowances or rebates to retailers, ostensibly to support the marketing costs of the growers' crops. In practice, however, growers report that these "pay to play" payments rarely result in visible benefits and may only serve to boost profit margins for retailers. Many of these requests for payments come in the form of per package "rebates" that have no relation to product performance. One request by a large retailer involved a per package contribution in order to fund the construction of its new produce distribution center. So, in addition to growers having to finance their own operations, they are also being asked to make direct payments to pay for capital improvements for their customers.

Slotting fees have been a mainstay in the dry goods sections of retail supermarkets for many years, but are now finding their way into the produce department. These are fees charged by some retailers to place an item in store-level distribution. They can consist of a slot in a retailer's warehouse or for space on a store shelf. We would argue that slotting fees have no place in the produce department of a supermarket. The highly perishable and seasonal nature of the industry makes it impractical. Because fruits and vegetables are priced at the farm gate based on supply and demand forces, these are costs that cannot be passed along to the ultimate customer - the consumer. Small to medium sized fruit and vegetable growers simply cannot compete for limited shelf space with large, multinational food companies. Finally, these fees are not related to new product development and marketing. The bottom line is that growers cannot recover the costs of slotting fees, allowances or rebates in the marketplace. Ultimately, the cost of this "pay to play" practice comes from growers' profit margins, which in today's environment are very slim and in some cases non-existent. Consumers suffer, as well, with fewer choices at the supermarket and higher prices.

Growers tell us other marketplace issues have developed as consolidation in the food retailing industry has increased over the past several years. The Perishable Agricultural Commodities Act (PACA) establishes fair trading rules for fruit and vegetable sellers and buyers in the United States, including terms on prompt payment. In recent years, retail buyers have put increasing pressure on growers to agree to terms outside PACA regulations. The net impact of this for a grower is not only the loss of the use of his money, but also the potential loss of his rights under the trust provisions of the law. This could prove disastrous to a grower should his customer file for bankruptcy protection. In order to keep business, growers also report that they more frequently have to accept "take-it-or-leave-it" price adjustments on product after delivery, even though there are no defects that would warrant such a reduction.

These are but a few of the marketplace issues and trading practices that growers face. These demands have increased in frequency and variety as consolidation has occurred within the food retailing industry.

FFVA appreciates the committee conducting a hearing on this important issue. We look forward to working closely with you to ensure a competitive and fair trading system that benefits both industry and consumers.

Chairman BOND. Thank you very much, gentlemen.

In both your written and oral statements, several of you touched on the problem with getting farmers to come forward and testify even anonymously about the charging of slotting fees. Why are your members so reluctant to talk publicly about the issue?

Mr. Stenzel.

Mr. STENZEL. It is a very difficult issue, Mr. Chairman. Clearly, these are buyers and sellers in the marketplace. When our members have a relationship with a particular retail customer the last thing they want to do is call that customer out, if you will, and talk about what is an extremely controversial subject. I think it is very clear to everyone in the room and certainly to the Committee that the retail industry is not here to defend these practices. I think that is part of the problem, that this has been that "dirty little secret" that you talked about in your introduction.

The more we can do to bring this area out into the light, let us talk about these fees and if they can be justified, if they help the consumer, then fine. But let us have it discussed and transparent and not cloak it in the hidden area between just that business relationship where one party is in such a weaker position.

Chairman BOND. We found in our hearing a year ago that out of some 80-plus people we talked to only 6 of them agreed to testify, 3 of those backed out. Two of them actually came with hoods on and disguised voices. Frankly, we had to go to great lengths to get them. This year we found that the fears were even greater. Mr. Moore, how does it look from your standpoint?

Mr. MOORE. Yes, we have had some cases where people have challenged the retailer—not only do they lose the business, they will never be able to do anymore business with that retailer. They have a way of going out and warning the others, "Are you going to do business with that . . ." and I will use the term, ". . . SOB?" We have actually had people cut out of the market—not only the one that he is maybe addressing, having a problem with, or has challenged some of their practices, but as a result of their complaints, they have been driven out of business.

Chairman BOND. Mr. Stuart, I might add another question here. During the investigation the Committee heard arguments that fees charged to growers whether variable or fixed really are passed along to consumers in the form of lower prices and that they do benefit growers. Have you any information on whether price decreases have been associated with fees paid by growers and do your members see any benefit for them in these up-front fees?

Mr. STUART. Mr. Chairman, quite the opposite. If I had to list all of the calls I get on a weekly or a monthly basis from my members, this particular issue ranks head and shoulders above any other in terms of an issue that brings more—the most emotion to the table in terms of marketplace practices. The reason they are calling is because they see no value in the marketplace. They see, as these charts exemplify, over the last few years the returns back to the grower, back to the farm being reduced, and becoming tighter to the point where you have got a lot of red ink on the balance sheet, yet they see this disparity between the farm price and the retail price seem to grow on an annual basis.

So no, I do not see that there is any benefit whatsoever back to the grower at this point in time. I see no evidence whatsoever that there is any benefit to the consumer, certainly not if you look at some of these markups and see what the retailers are charging for some of these products in various cities around the country.

Chairman BOND. Mr. Moore, you testified that besides being president of the Western Growers, you are also a produce farmer. Have you experienced personally any of these demands for fees?

Mr. MOORE. Yes, I have, Mr. Chairman, and a lot of time if it is not directly, it will be because sometimes I am forced to send my product through another larger shipping organization. It gets passed through to growers so naturally those fees have to be paid by someone. So I am affected on the products that I grow.

Chairman BOND. Are any of you finding that these fees are charged only in connection with exotic produce such as star fruit, or are they charged across the board for the basics that we all get in the produce department?

Mr. MOORE. I will use some examples. We truly understand why the retailers—are renting space. If they have a product come in, they do not know if it is going to move. A few years ago we had a product called broccoli flower. Well, when it first hit the market, they did not know if it was going to move or not. We understand why you might have to do something to encourage the retailer to have that space used for that. Items such as that or when these, what we call value-added products, the lettuce mixes and all that, when they first started they were not moving out rapidly. So we understand why you have to do something to get your product on the shelf.

But again, the perfect example you made when this hearing started, what is new about a cantaloupe, an orange, a potato, or a head of lettuce? I mean that is the part that bothers me. These are pretty standard and we know that they are going to move and why isn't the 400 percent to 800 percent markup enough without having to go to these other measures?

Chairman BOND. Mr. Stenzel, BATF has prohibited the payment of slotting fees in relation to marketing of alcohol on the grounds that the fees do not promote competition or benefit consumers. Now we understand there are special policy considerations surrounding the sale of alcohol, giving BATF the authority but is there any reason why the similar rationale should not apply in produce?

Mr. STENZEL. Mr. Chairman, I think one of the most important things that this Committee has been able to do with your leadership thus far is to work with the Federal Trade Commission to really get the Bureau of Competition energized. We salute what you have done with adding the $900,000 in their budget for this particular issue. They have got to look at that. They have got to look seriously at what type of regulation might be appropriate in this whole area of slotting fees for perishable products where they are clearly not appropriate.

I think it is important that the FTC looks at guidance to the industry. That may be certainly an outcome of the hearings, the 2-day hearings that the FTC held earlier. I think they have got to look at transparency. Again, I am going to come back to that as I think the light of day shines an awfully big spotlight, and that may be our ultimate best solution.

Chairman BOND. Do any of you know of any instance where there is disclosure to any of the ultimate consumers of your produce? Do consumers have any idea about the payment of fees going on to get that produce on the market?

Mr. STUART. No evidence of that whatsoever that I have seen.

Mr. MOORE. None whatsoever.

Chairman BOND. Mr. Stenzel.

Mr. STENZEL. No, and in fact, Mr. Chairman, we do not find it in terms of disclosure and financial accounting within the retail supermarket industry. I think that is one of the concerns, as economic theory might hold that some of these payments, particularly if they are variable payments or volume-based would be passed on to the consumer. But that is making the supposition that they are used to reduce the cost of goods sold.

Clearly, in many of these cases these payments are accounted for and there is no relationship to reducing the cost of goods sold to the consumer. So not only are they not disclosed to the consumer generally, they are not disclosed in accounting particularly at the retail level.

Chairman BOND. If they are not disclosed, that is something our friends at the IRS might be interested in. That is another problem. In the slotting hearing in 1999, we heard instances of special payments which included things like hiring babysitters and buying cars that probably did not show up in anybody's 1099 or their 1040.

We have been joined by my colleague from Montana, Senator Burns. Would you have any questions? Is there anything that you would like to put in at this point?

OPENING STATEMENT OF THE HONORABLE CONRAD BURNS, A UNITED STATES SENATOR FROM MONTANA

Senator BURNS. Thank you, Mr. Chairman, and thanks for this hearing. I did not know you started at 1 o'clock. I thought it was 1:30 and here I come along, I am consequently a little late and I want to apologize for that.

These slotting fees and selling shelf space, I understand that Safeway is not buying any domestic lamb now, they only want New Zealand Lamb and things like that, strike the fear of the heart of all of us who represent the agricultural community. We do not know how to break this practice to be honest with you.

Things are not good on the farm. We are selling wheat now for less than we did before World War II. We are not getting along very well out there, but yet our cost of pickups and equipment and everything else keeps going up and we are really in a bind. And we do not see one son of a gun in this country who gives a damn, not one, not a packer or a processor or purveyor or a grocery store trying to keep our people, producers, in business. Not one.

I think we are at the end of things. I have said what has been wrong with agriculture for a long time, we cannot get enough of the consumer dollar back to the farmer or ranch. But as long as this country has its belly full, consumers will not, they are not going to care. Do you realize right now if I could gather up enough money to invest in an oil well on a speculative basis or a gas well, do you know how long it would take to put together a drilling crew? Forty-five days.

Our ability to look for, discover and lift petroleum from this earth, that infrastructure has been decimated because all of those roughneckers went to work somewhere else. The same thing is going to happen in agriculture. It will happen because we cannot take these low prices. And we have got very few people to replace now. We have got a lot of people who think they can farm but they will find out how hard it is, you know. They do not pass along the consumer dollar and it is a bad situation.

We have had a lot of mergers at the processing level. That means that in livestock you have got three packers killing 85 percent of the cattle. We do not take it far enough as far as antitrust and who holds the key, who has got their hand around the sack. I am here to tell you that we have a crisis in American agriculture right now. It is a crisis. And this slotting business and this selling of shelf space is killing us. You can have the best product in the world and it won't get sold. I just brought this along because we had a little lunch today.

How come you started at 1 o'clock anyway?

Chairman BOND. The staff, they did not want me to stay there for that blueberry cobbler.

Senator BURNS. I brought you some jam.

Chairman BOND. I wanted the cobbler.

Senator BURNS. I will go back and get you the cobbler.

Chairman BOND. That is a deal.

Senator BURNS. But this is what we are talking about. This is the thing, what we are talking about. I can have a mediocre product, which might not be worth anything but if I have a big checkbook, I can get shelf space, not because of the product, because of the checkbook. And that worries me, that really worries me. So as far as questions go, I do not have any. I want to put my statement in the Record.

Chairman BOND. Without objection.

[The prepared statement of Senator Burns follows:]

Opening Statement for Senator Conrad Burns
Committee Small Business Hearing on Slotting Fees
September 14, 2000

Mr. Chairman, thank you for the opportunity to address the committee today. I believe that the issue before us is one of the most important issues facing America's agriculture community. Quite simply, they are being forced out of our own grocery stores.

Concentration in the agriculture industry strikes fear in the heart of every single family farmer and rancher out there. When portions of the industry concentrate it takes options away from us. Without those options, we lose the ability to control our cost of production, and the cost we must bear to get our product to market.

Today, this hearing is about the impact on produce, however, slotting fees in our grocery stores impact all foodstuffs, and American producers are shouldering the brunt of the impact. In Montana, cattle producers continue to have a hard time with concentration in the packing industry. Rather than being willing sellers, our cattlemen are captive sellers. They don't get an option on price. I have spent a lot of time looking for ways to reduce the negative impacts of concentration on our farmers and ranchers. I have pushed for price reporting legislation and other measures to make sure producers can make informed decisions. However, I have also spent time looking for the source of concentration. What I found was cause for concern.

Grocery chains have an enormous influence on the market. They are the closest ones to the consumer, and the ones who give the consumer the ultimate option on what is available to buy. If it isn't in the store, it isn't going to be purchased. Consumers don't have a whole lot of options. The latest figures I have seen illustrate that in 1995 the top five grocery chains controlled 25 percent of the market. Today, the top five chains control 40 percent of the market. Obviously, concentration goes further than just the packing industry.

One chain has "slotted," or sold to the highest bidder, their entire lamb case. Unfortunately, in doing so they shut American producers out of the market. Only New Zealand lamb can occupy the shelf. Tell me how that is free-market trade at work?

Additionally, slotting raises our costs. Producers are seeing less and less of the consumer dollar. Now, we are expected to pay to get our product on the shelf. We can't get an honest price and now the grocery stores, who should be our greatest allies, are nickel and dime-ing us to death.

We are on the verge of losing a lot of hard-working agriculture producers. They supply our country with a safe and reliable food supply. Our grocery chains should support that, not lock us out of the market by auctioning off our shelves to foreign competitors. America's beef producers, lamb growers, wheat farmers, and every other producer can not continue to have corporate America stack the deck against them.

Senator BURNS. And I think as we see this thing unfold and take a look at it next year, I think there are several of us that will have a lot of ideas about how we will get more dollars back to the man on the land because he is hurting.

I went to a funeral of an old cowboy friend of mine. He was 100 percent cowboy, 76 years old. He went out, stepped on his horse in the latter part of August, and the old horse kind of got a cold back. He bucked a little bit, and threw him off. My good friend's head hit a fence post and now he is in the ground. But he went in the ground happy and I think in agriculture he is probably in the best place right now. I really do.

But, we have got some real problems and we are going to have to come up with some people who care. And I have not seen those people surface yet.

Thank you, Mr. Chairman.

Chairman BOND. Thank you very much, Senator Burns. Obviously, the Senator from Montana is one who does.

Gentlemen, we appreciate very much your testimony. We are delighted to have you here. We will leave the Record open for further questions and if any of the Members who are tied up in other meetings have questions, we will submit those for the Record and ask you at your earliest convenience to respond. If any of you have any further comments based on what goes on here today, the Record will be open for 2 weeks. Anything else you want to add, Senator Burns?

Senator BURNS. No.

Chairman BOND. Thank you again, gentlemen.

Mr. MOORE. Thank you, Chairman.

Mr. STENZEL. Thank you, Mr. Chairman.

Chairman BOND. Our second panel is comprised of Lawrence Dyckman, Director, Food and Agriculture Issues, Resources, Community, and Economic Development Division of the U.S. General Accounting Office; accompanied by Andrea Brown, Assistant Director, Food and Agriculture Issues, Resources, Community, and Economic Development Division of the U.S. General Accounting Office; Susan Offutt, Administrator of the Economic Research Service of the U.S. Department of Agriculture in Washington; and Professor Gregory Gundlach, College of Business Administration, University of Notre Dame in Notre Dame, Indiana. Thank you very much for joining us.

Mr. Dyckman.

STATEMENT OF LAWRENCE J. DYCKMAN, DIRECTOR, FOOD AND AGRICULTURE ISSUES, RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE, WASHINGTON, D.C.; ACCOMPANIED BY ANDREA BROWN, ASSISTANT DIRECTOR, FOOD AND AGRICULTURE ISSUES, RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE, WASHINGTON, D.C.

Mr. DYCKMAN. Good afternoon, Mr. Chairman. With me is Andrea Brown, Assistant Director, who has been responsible for our attempt to work on slotting fees. Again, I want to thank you for the opportunity to be here today to discuss our plans to study the use of slotting fees in the grocery industry.

Slotting fees are generally payments from grocery manufacturers to retailers to introduce new products. As you are well aware, there is much anecdotal information about the use of slotting fees and its impact on small business and consumers but very little hard evidence is available. You, therefore, asked us to conduct a study illustrating the use of slotting fees by individual companies for various grocery items. In making this request, you recognized that we would have to rely on the voluntary cooperation of the grocery industry. It has not been a successful effort on our part.

In short, despite repeated attempts over the last 8 months, we have been unsuccessful in gaining the cooperation needed from the industry to conduct this study. Industry officials expressed concern about providing us or any outside group information that they consider sensitive and proprietary and thus critical to their business success.

In your letter of October 20, 1999, you requested that we study the grocery industry's use of slotting fees. Your letter also stated that the Food Marketing Institute (FMI) and the Grocery Manufacturers of America (GMA), the two primary associations representing the industry, but not present today, had assured you of their cooperation in our study.

Our overall plan was to conduct case studies of slotting fee practices in the industry for various supermarket items at several food manufacturing companies and grocery store chains. The associations were to work with us to identify companies willing to speak with us and to provide documentation to us.

However, companies are not required to provide us access to their internal documents or discuss these trade practices with us. Once the companies were identified, however, we planned to visit them to discuss the extent of their use of slotting fees and obtain documentation on the dollar amounts of slotting fees on several food categories, accounting practices for these fees, and related company policies and procedures.

We planned several strategies to safeguard the company data we would be receiving. First, we planned to break the link between the information and the source, and not attribute information in our report to any one company or individual. Second, we planned to safeguard this information. Third, we explained to the industry associations that we are not subject to the Freedom of Information Act and that we do not disclose to the public any of our records containing trade secrets and commercial or financial information.

We also obtained a pledge of confidentiality from you, Mr. Chairman, to safeguard specific company information from disclosure to your Committee, its staff and any other Members.

In separate meetings in January 2000, we met with leaders of the FMI and GMA to discuss our study approach. The associations told us that they do not compile detailed information on slotting fees because of its sensitive nature, and that we would have to obtain slotting fee information from individual member firms.

Over a period of several months we sought from FMI grocery companies that would be willing to give us detailed information on slotting fees. FMI stated that several members they contacted would not even want speak to us. However, the association did identify two mid-size grocery chains that might be willing to meet with us. Both of these grocery chains eventually did meet with us, and we did discuss slotting fees in general terms but neither provided documentation nor specific information about the use of and accounting for slotting fees in their businesses.

GMA, unfortunately, was even less successful in helping us gain access to members and information. On our own we discussed slotting fees with a mid-size grocery store chain and three food manufacturers. Again, none of these companies were willing to provide us with the type of documentation or the specific information we were seeking.

Mr. Chairman, this concludes my prepared statement. We would be happy to answer any questions after the witnesses finish.

[The prepared statement of Mr. Dyckman follows:]

Lawrence J. Dyckman,
Director, Food and Agriculture Issues
Resources, Community, and Economic Development Division
U.S. General Accounting Office

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to be here today to discuss our effort to study the use of slotting fees in the grocery industry. In the grocery industry, slotting fees—sometimes called slotting allowances—are generally payments from grocery manufacturers to retailers to introduce new products on the retailers' shelves. As you are aware, there is a lot of anecdotal information about the use of slotting fees by the industry and its impact on small businesses and consumers, but little hard evidence is available. You therefore asked us to conduct a study illustrating the use of slotting fees by individual companies for various grocery items. In making this request, you recognized that we would have to rely on the voluntary cooperation of the grocery industry to collect this information.

In short, despite repeated attempts over the last 8 months, we have been unsuccessful in gaining the cooperation needed from the industry to conduct this study. Industry officials expressed concern about providing us or any outside group information that they consider sensitive and proprietary and thus critical to their business success.

My testimony today will focus on our efforts to conduct this study for you. In particular, we will highlight (1) our planned approach and methodology and (2) the reasons we were unable to perform the study.

Background

The term "slotting" originally referred to slots or spaces for pallets in warehouses that had to be created when products were added to the line of products stocked by the grocery chain. The most common slotting fees are payments from food manufacturers to grocery chains for new products, called new product introduction fees. Other payments that are also referred to as slotting fees may include payments for premium product placements, such as on eye-level shelves or special displays; fees to have products remain on shelves—called pay-to-stay fees; or fees paid if a product fails.

Some argue that slotting fees are a normal economic response to the costs of putting an expanding number of grocery products on retailers' shelves. They believe the fees are justified to cover the costs of introducing a product and to remove the item that previously occupied space in the warehouse and on the store shelf. Others contend that slotting fees reflect the grocery chains' market power, stifle innovation, squeeze out smaller manufacturers, and, ultimately, raise prices to consumers.

Our Planned Approach to Studying the Use of Slotting Fees

In your letter of October 20, 1999, you requested that we study the grocery industry's use of slotting fees. We agreed with your staff that the overall objectives of our work would be to (1) describe the types of slotting fees being used, (2) document the amounts manufacturers pay for the various types of slotting fees, (3) determine how manufacturers and retailers account for the payment and receipt of these fees, and (4) describe the policies and procedures of grocery manufacturers and retailers regarding slotting fees. Your letter further stated that the Food Marketing Institute (FMI)[1] and the Grocery Manufacturers of America (GMA),[2] the two primary associations representing the industry, had assured you of their cooperation in our study. At meetings on January 5 and 20, 2000, we discussed with your staff the fact that GAO does not have legal authority to access this private-sector information, and we would thus depend on cooperation from grocery manufacturers and retailers to complete this review.

Our overall plan was to conduct case studies of slotting fee practices in the industry for various supermarket items at several food manufacturing companies and grocery store chains. The industry associations were to work with us to identify companies willing to speak with and provide documentation to us. We would have preferred a more systematic approach for selecting companies in our study. However, companies are not required to provide us access to their internal documents or discuss these trade practices with us. Once the companies were identified, we planned to visit them to discuss the extent of their use of slotting fees. We also planned to obtain documentation on and analyze the (1) dollar amounts of slotting fees on several food categories, (2) accounting practices for these fees, and (3) related company policies and procedures.

After completing our audit work, we planned to issue a report to the Committee describing what we had learned about slotting fees. Our methodology was designed to produce an informational report that would not contain any conclusions or recommendations. We did not design our study to address the controversial issues surrounding slotting fees, such as the impact of slotting fees on competition, small businesses, and consumers.

From the Committee's hearing last year we knew that confidentiality would be required to enhance industry's cooperation. Therefore, we planned several strategies to safeguard the company data we would be receiving and analyzing. First, we planned to break the link between the information and the source. For example, we would prepare workpapers that were written summaries of meetings and documents from various sources so the information would no longer be tied to a specific company. We have

[1] The Food Marketing Institute is an association representing food retailers and wholesalers.

[2] The Grocery Manufacturers of America is an association of food, beverage, and consumer product companies.

employed this practice on numerous studies before. Also, we would not attribute information in the report to any one company or individual.

Second, we planned to safeguard the information, as required by the company. For example, we would place company data in a locked secure cabinet or safe. Furthermore, we train our staff members in handling and safeguarding government classified, business-sensitive, proprietary, and other types of nonpublic documents.

Third, we explained to the industry associations our policies and procedures on disclosing information. Specifically, we informed them that we are not subject to the Freedom of Information Act. Furthermore, we told them that when members of the public request records obtained from a federal agency or nonfederal organization in connection with our work, we refer the public to the agency or organization that originated the record.[3] We also do not disclose to the public any of our records containing trade secrets and commercial or financial information obtained from a person that is privileged and confidential.[4]

While GAO is not subject to the Freedom of Information Act, Members of Congress can request our workpapers. Therefore, we obtained a pledge of confidentiality from you, Mr. Chairman, to safeguard specific company information from disclosure to your Committee and its staff. In your letter dated May 16, 2000, you pledged that:

"...Neither the Committee nor the Committee staff will seek from GAO information that might identify any particular manufacturer or retail outlet or any information that would allow a knowledgeable person to identify a particular manufacturer or retail outlet."

In addition, you stated that if any other Member of Congress requests such information, you will inform them of your agreement not to request such information and will encourage the Member to withdraw the request.

Detailed Information on Slotting Fees Was Not Made Available

In separate meetings in January 2000, we met with leaders of FMI and GMA to discuss our study. The trade associations told us that they do not compile detailed information about slotting fees because of its sensitive nature and we would have to obtain slotting fee information from individual manufacturing and retail companies. We explained that individual companies have no obligation to provide us access to their records. Thus, we would have to rely solely on voluntary cooperation. At those initial meetings, each

[3] See 4 C.F.R. Section 81.5(a) (1999).

[4] See 4 C.F.R. Section 81.6(e).

association said it would inquire among its members and put us in contact with those that would be willing to work with us.

Over a period of several months, we sought from FMI grocery companies that would be willing to work with us and provide us detailed information on slotting fees. FMI stated that several of the members they contacted did not want to speak with us. However, the association did identify two mid-size grocery chains that might be willing to meet with us. Both of these grocery chains eventually met with us and discussed slotting fees in general terms. They explained that there are real costs and risks associated with putting new products on their shelves and thus charging slotting fees is a necessary business practice. However, neither provided documentation nor specific information about the use of and accounting for slotting fees in their businesses.

GMA was even less successful in helping us gain access to the information we needed. To enhance the probability of their members participating in our study, the association suggested that we obtain from you, Mr. Chairman, the pledge of confidentiality letter. Although we provided GMA with your pledge of confidentiality, the association was unable to identify any of its members willing to cooperate with us or even meet with us. We also provided a copy of your letter to FMI, but this did not result in any additional companies willing to participate in our study.

Without the assistance of FMI or GMA, we discussed slotting fees with a mid-size grocery store chain and a meat products manufacturer as well as a small ethnic foods manufacturer and a small snack foods manufacturer. None of these companies was willing to provide us documentation or specific information about their use of slotting fees.

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This concludes my prepared statement. I would be pleased to answer any questions you or Members of the Committee have.

Contact and Acknowledgement

For future contacts regarding this testimony, please contact Lawrence J. Dyckman on (202) 512-5138. Individuals making key contributions to this testimony included Andrea Brown and Thomas Cook.

(150166)

Chairman BOND. Thank you very much, Mr. Dyckman.
Ms. Offutt.

STATEMENT OF SUSAN E. OFFUTT, ADMINISTRATOR, ECONOMIC RESEARCH SERVICE, U.S. DEPARTMENT OF AGRICULTURE, WASHINGTON, D.C.

Ms. OFFUTT. Good afternoon, Mr. Chairman. I am pleased to be here this afternoon to discuss the preliminary findings of our ongoing study, fresh fruit and vegetable markets, retail consolidation and trade practices. It focuses on recent structural and marketing changes in the produce industry.

Just last week the Economic Research Service published the first in a series of reports associated with this project, "Understanding the Dynamics of Produce Markets: Consumption and Consolidation Grow."

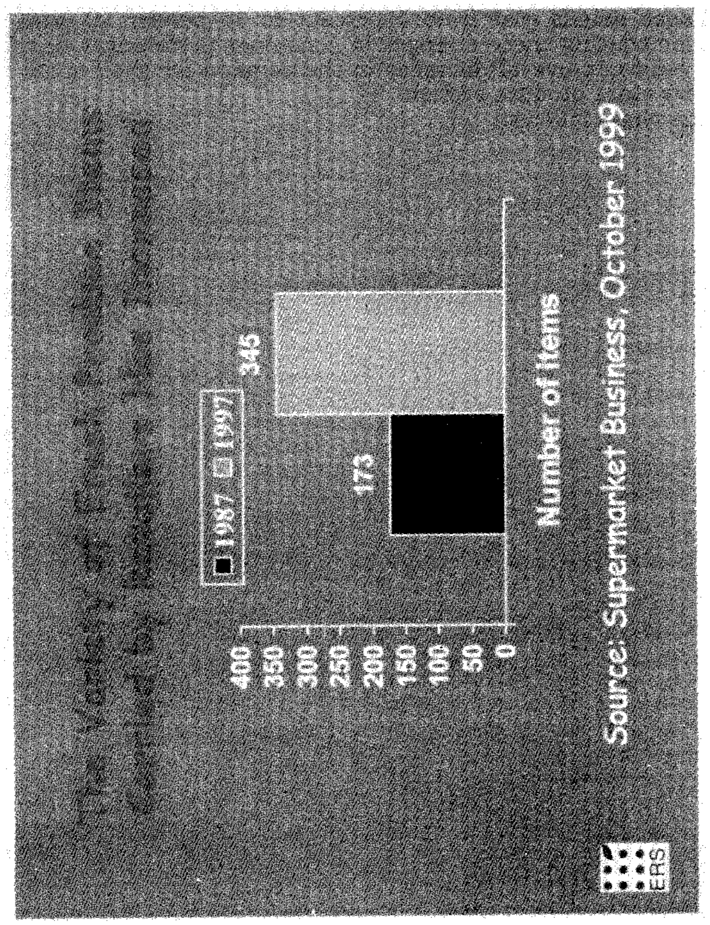
Today I will talk about the preliminary results of industry interviews on trade practices. The final report is to be published at the end of the year. A third report on retailer market power will be published this coming spring.

The produce marketing industry has evolved considerably since the 1980s. These changes are partly the result of shifts in consumer preferences for produce and partly of the reorganization of the structure of the industry itself. Americans have become more health conscious and as a result are eating more fresh fruits and vegetables than ever. At the same time, consumers demand variety and convenience.

Retailers have responded to consumers by expanding the variety of products offered. Stores now offer year-round availability of many fruits and vegetables, pre-cut produce and more packaged and branded products.

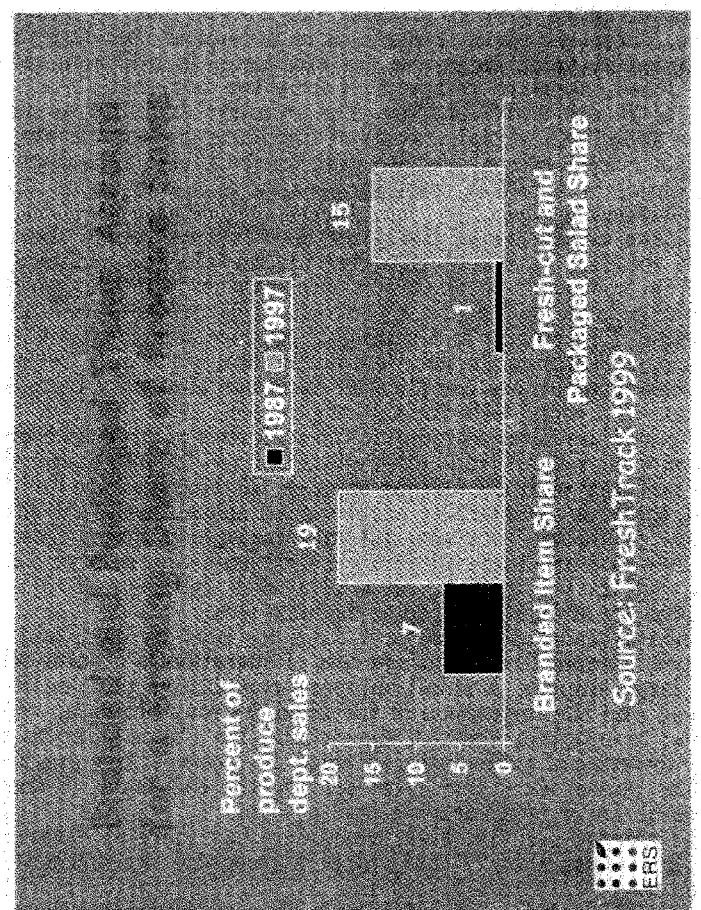
The first chart which appears to my left shows that the number of fresh produce items carried by retailers doubled in 10 years, from 173 in 1987 to 345 in 1997.

[The chart follows:]


1987
1997
345
173
400
350
300
250
200
150
100
50
0
Number of Items
Source: Supermarket Business, October 1999
ERS

The second chart which is to my right shows that during the same period the share of branded produce increased from 7 percent to 19 percent of total sales while the share of fresh cut produce and packaged salads rose from 1 percent to 15 percent of total sales. Accommodating these changes in consumer preferences has, therefore, led to an overall increase in the demand for shelf space in the grocery store produce section.

[The chart follows:]


Percent of produce dept. sales
20
15
10
5
0
1987
1997
7
19
1
15
Branded Item Share
Fresh-cut and Packaged Salad Share
Source: FreshTrack 1999
ERS

Since rapid retail consolidation began about 5 years ago, the nature of transactions and coordination between produce shippers and retail buyers has evolved. Consolidation in the retail industry has occurred as growth in sales has slowed due to stable food prices. There have been reductions in household spending for food consumed at home as people eat out more. In addition, retailers have faced increased competition from the non-traditional sector, such as Costco and Wal-Mart. The retailers' inability to increase prices added to the higher costs of providing greater variety, additional services, as well as new store formats have encouraged grocery retailers to offset costs by seeking efficiency gains through consolidation.

To take advantage of the potential efficiency gains, the fewer, larger retailers have been changing the way they do business, moving from spot cash purchases in wholesale or terminal markets to greater reliance on long-term contractual agreements and strategic alliances. The buying and selling of produce has consequently become more complex. In today's transactions, price may be just one component of a more complicated exchange that may include fees and services, along with the sale of produce.

Of particular interest today is the incidence of fixed and variable fees or what we call trade allowances. A fixed fee is a payment that does not vary with the volume of sales. Slotting fees are defined as fixed, up-front payments to acquire shelf space for the introduction of new products. They are but one example of these fixed fees. Variable fees are assessed on a per unit basis and so over a season vary with the volume sold. Advertising fees, rebates and volume incentives are often structured as variable fees.

When a trade allowance is a fixed fee paid by each and every shipper, a small firm's average cost of operation is greater relative to a large shipper. A small shipper's competitive position may be eroded, and the imposition of the fixed fee may act as an effective barrier to entry. In contrast, the variable fee affects shippers equally by lowering the effective unit price. In a competitive market, the retailer passes along the lower price to the consumer, in the form of overall lower retail prices or sales prices.

The shipper benefits when consumers buy more at lower prices. Our interviews showed that shippers recognize the distinction between fixed and variable fees and, in fact, shippers are more likely to complain about a fixed fee, such as a slotting allowance. However, it was the case that not all fees and services were viewed as detrimental to the interests of shippers. Variable fees, such as performance-based volume incentives and promotional fees, may help product movement and may provide competitive advantage but shippers may question whether these fees actually increase demand for their product, either because of limited consumer response to the price changes or to a lack of accountability regarding the retailer's performance.

Based on the information obtained in our interviews, we find that most shippers and retailers reported trade allowances, that include fixed and variable fees, and services had increased in incidence and magnitude over the last 5 years. The predominant type of fees charged in bulk produce sales were variable fees which included volume incentives, promotional allowances and other per unit rebates. Fixed fees, which would include slotting fees are also more likely to be associated with sales of fresh-cut and value-added items as compared to the bulk produce.

Our analysis required information on the terms of exchange between produce shippers and retailers. When these exchanges occur in spot transactions in terminal markets, prices are easy to observe. Indeed, the USDA collects and publishes just such data on prices. However, when exchange takes the form of direct sales, or a proprietary agreement between a supplier and a retailer, its terms, that is prices, trade allowances, services required, are not so easily observable.

As the produce business has moved increasingly to direct sales, we have had to adjust in the way we conducted this study to turn to a limited number of time-intensive, detailed personal interviews with fresh fruit and vegetable shippers and national and regional retailers. The main disadvantage of this approach is the lack of uniformity in response, with respect to the details on the terms of exchange, on exactly how much people will tell us about a fee, how often it is charged and its size.

There are also concerns when we are limited in the number of interviews we can do about how well the respondents actually represent industry norms.

Let me close by noting that our study focuses so far just on the terms of exchange between shippers and retailers. We did not examine the upstream relationship between growers and shippers. While some growers are also shippers, many are not, and our future work will seek to consider how growers experience the effects of the increased incidence and magnitude of these trade allowances, of the fixed and variable fees. Growers and shippers may benefit or suffer equally when retailers offer incentives or require fees, but if there is a lack of competition in the market between growers and shippers, the opportunities for passing the fees on to growers certainly exists.

Thank you very much. I would be pleased to answer any questions at the end of the presentations.

[The prepared statement of Ms. Offutt follows:]

Statement by
Susan E. Offutt, Administrator
ECONOMIC RESEARCH SERVICE
U.S. Department of Agriculture

Before the U.S. Senate
Committee on Small Business
September 14, 2000

Introduction

Good afternoon Mr. Chairman and members of the Committee. I am pleased to be here this afternoon representing the Department on the issue of fruit and vegetable marketing, particularly as it relates to retail consolidation and recently emerging trade practices.

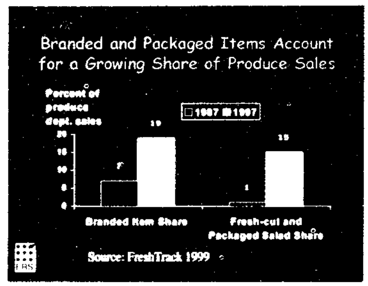
The mission of the Economic Research Service (ERS) is to conduct economic analyses on efficiency, efficacy, and equity issues related to agriculture, food, the environment, and rural development. The agency's goal is to understand the changing nature of complex economic relationships and behaviors that affect the agricultural economy. As a research agency, ERS ultimately aims to generate objective economic intelligence that would guide informed policy and political decision making processes rather than to regulate the economy.

In my remarks, I will discuss the preliminary findings of the ongoing study *"Fresh Fruit and Vegetable Markets: Retail Consolidation and Trade Practices"* that focuses on recent structural and marketing changes in the produce industry. Last week, ERS published "Understanding the Dynamics of Produce Markets: Consumption and Consolidation Grow," a description of aggregate changes in marketing channels and firms. The agency anticipates publishing results of industry interviews on trade practices at the end of this year. A third report on retailer's market power is targeted for release in spring of 2001.

The genesis of our study is twofold. First, ERS has embarked on a broad-based effort to enhance understanding of the changes in market structure that are taking place all across the agriculture and food sector and the effects of these changes on livestock, grain, and produce farmers, shippers, processors, retailers, and consumers. Second, and more specifically, the study responds to a letter sent to Secretary Glickman by seven produce associations requesting that ERS undertake an objective study examining retail consolidation and trade practices in the fresh produce industry.

Study on Trade Practices

The produce marketing industry has evolved considerably since the 1980s. These changes are partly the result of shifts in consumer preferences for produce and partly of



the reorganization of the structure of the industry itself. Americans have become more health-conscious and as a result are consuming 33 pounds more fresh fruits and vegetables per capita than in 1987. As consumption has increased so has the demand for variety and convenience. For example, with the introduction of fresh-cut carrots, per capita consumption of fresh carrots increased from just over four pounds in 1987 to 13.5 pounds in 1998. At the same time, traditional varieties of some commodities have lost market share. For example, per capita consumption of iceberg lettuce fell by about three and half pounds between 1987 and 1998, while consumption of romaine and leaf lettuces grew by more than four pounds.

Retailers have responded to this shift in consumer preference by expanding the variety of products offered. Stores now offer year-round availability of many crops, pre-cut produce, and more packaged and branded products. The number of fresh produce items carried by retailers doubled in ten years, from 173 in 1987 to 345 in 1997.
During the same period, the share of branded produce increased from 7 percent to 19 percent of total sales, while the share of fresh-cut produce and packaged salads rose from 1 percent to 15 percent of total sales. Accommodating these changing in consumer preferences has, therefore, led to an overall increase in the demand for shelf space in the grocery store produce section.

Since rapid retail consolidation began in 1996, the nature of transactions and coordination between produce shippers and retail buyers has evolved. Measured as a decadal change, the largest four retailers' share of grocery store sales in 1998 rose from 17 to 27 percent. Similarly, the 8 largest retailers' share increased from 26 to 38 percent, while the 20 largest retailers' share increased from 37 to 48 percent of total grocery store sales. The primary factors influencing consolidation are the slow profit growth of retailers due to stable food prices, slowing growth in at-home food spending, the increasing share of the food dollar spent away from home, and the growth of food sales by nontraditional retailers. The retailers' inability to increase prices along with the higher costs of providing greater variety, additional services, and new store formats have encouraged grocery retailers to offset costs by seeking efficiency gains through consolidation.

To take advantage of the potential efficiency gains, the fewer, larger retailers have been changing the way they do business, moving from spot cash purchases in wholesale or terminal markets to greater reliance on long-term contractual agreements and strategic alliances. The buying and selling of produce has consequently become more complex. In today's transactions, price may be just one component of a more complicated exchange that may also include fees and services, along with the sale of produce. The objective of the study is to understand why and how these trade practices are changing and what effect they have on economic actors in the produce marketing chain.

Of particular interest today is the incidence of fixed and variable fees or trade allowances. A fixed fee is a payment that does not vary with the volume of sales. Slotting, pay-to-stay, and failure fees are a few examples of fixed fees. Slotting fees are defined as fixed, up-front payments to acquire shelf space for introduction of new products. In contrast, variable fees are assessed on a per unit basis and so over a season vary with the volume sold. Advertising fees, rebates, and volume incentives are often structured as variable fees.

When a trade allowance is a fixed fee paid by each and every shipper, a small firm's average cost of operation is greater relative to a large shipper. A small shipper's competitive position may be eroded, and the imposition of the fixed fee may act as effective barrier to entry. In contrast, a variable fee affects shippers equally by lowering the effective unit price. In a competitive market, the retailer passes along the lower price to the consumer, in the form of overall lower retail prices or sales prices. The distinction between fixed and variable fees is therefore critical.

The shipper benefits when consumers buy more at lower prices. Our interviews showed that shippers recognize the distinction between fixed and variable fees and are more likely to complain about a fixed fee, such as slotting allowances. However, not all fees and services are viewed as detrimental to shippers. Variable fees, such as performance-based volume incentives and promotional fees, may help product movement and provide competitive advantages. But, shippers may also question whether these fees actually increase demand for their products, either because of limited consumer response to price changes or lack of accountability regarding performance.

Based on information obtained in the interviews, most shippers and retailers reported that trade allowances (fixed and variable fees) and services had increased in incidence and magnitude over the last five years. The predominant type of fees charged in bulk produce sales were variable fees such as volume incentives, promotion allowances, and other per-unit rebates. For example, grape and orange shippers reported that per-unit fees accounted for 97 and 68 percent of fees paid, respectively. Smaller size shippers are less likely to pay fixed fees to retailers who require such payments. This reduction in business opportunities is a disadvantage to smaller firms. These fixed fees, which would include slotting fees, are also more likely to be associated with sales of fresh-cut and valued added items as compared to bulk produce.

Sources of Information

Our analysis requires information on the terms of exchange between produce shippers and retailers. When this exchange occurs in spot transactions in terminal markets, prices are easy to observe. Indeed, the USDA collects and publishes just such price data. However, when exchange takes the form of direct sales, a proprietary agreement between a supplier and a retailer, its terms (prices, trade allowances, services required, etc.) are not so easily observable. As the produce business has moved increasingly to direct sales, ERS could not rely on public data and instead had to conduct a limited number of time-intensive, detailed personal interviews with fresh fruit and vegetable shippers and with national and regional retailers. The disadvantage of this approach is the lack of uniformity in response (with respect to details on terms of exchange). As well, there are concerns about how well respondents represent industry norms.

The economic characteristics of the produce industry vary substantially across individual fruits and vegetables. For the study, researchers selected seven important products to study: California tomatoes, oranges, table grapes, lettuce, and bagged salads; and Florida tomatoes and grapefruit. Although the study focuses on fresh fruits and vegetables, it also includes bagged salads because this type of value-added, branded produce is gaining in importance and many of the new trade practices, such as slotting fees, are associated with sales of these products. A supplier brands a product to distinguish it from others with respect to quality or uniqueness, with the expectation that consumers will be willing to pay a higher price. Shippers invest heavily in advertising their branded products to develop consumer loyalty that requires long-term commitment to shelf space. Retailers are more likely to request slotting fees in this situation. In contrast, bulk produce from different suppliers is largely indistinguishable to consumers. This diminishes the rationale for paying slotting fees to retailers.

Researchers sought to interview small, medium and large shippers for each industry segment, asking for their voluntary cooperation. ERS researchers conducted interviews in tandem with faculty from Universities of Arizona, California-Davis, and Florida. These university cooperators often had working relationships with the produce trade associations and interviewees and played a large role in selecting the shippers to interview. The researchers conducted a small number of interviews compared to the large number of produce shippers and food retailers in the United States. Study findings cannot be construed as a large enough sample to provide results with statistical certainty—this is just a first step in understanding the recent changes in the produce industry. However, since the produce shipping industry is quite concentrated in some crops, even a small number of interviews covered a large percent of total shipper sales in some cases giving more confidence in the results.

This study focuses on the terms of exchange between shippers and retailers. We did not examine the upstream relationship between growers and shippers and the downstream relationship between retailers and consumers. While some growers are also shippers, many are not, and future work will seek to consider how growers experience the effects of increased incidence and magnitude of trade allowances. Growers and shippers may benefit or suffer equally when retailers offer incentives or require fees, but if there is a lack of competition in the market between growers and shippers, opportunities for passing the fees on to growers may exist.

I would be please to answer any questions. Thank you.

Chairman BOND. Thank you very much.
Professor Gundlach.

STATEMENT OF GREGORY T. GUNDLACH, PH.D., PROFESSOR OF MARKETING, MENDOZA COLLEGE OF BUSINESS, UNIVERSITY OF NOTRE DAME, NOTRE DAME, INDIANA

Mr. GUNDLACH. Thank you, Mr. Chairman and Members of the Committee. In summarizing my more lengthy statement I will concentrate on four main points.

Chairman BOND. I should have pointed out earlier as is standard practice, we make the full statements of all the witnesses part of the Record. And I apologize for not having done that. Thank you for summarizing.

Mr. GUNDLACH. Thank you. My first point regards the widening conceptual domain of slotting. As noted by others today, although originally defining supplier payments to obtain a slot in a wholesaler's warehouse, the term's meaning has expanded in practice. This expansion has led to varying interpretations and some confusion.

While some confine the term to its original meaning, others use it to refer to an assortment of trade-based payments that range across a product's entire distribution life cycle and to apply to both new as well as existing products. Opinions also differ as to what constitutes slotting based on the nature of payment terms that are involved. Some narrowly view payments that are unconditional, fixed in nature, handled off-invoice and paid up-front to be slotting fees. Others view slotting more broadly to encompass other payment terms.

Opinions also differ as to the characterization of slotting fees as either motivated by retailers and imposed on suppliers or motivated by suppliers and offered to retailers. Finally, though attention toward slotting has focused on its application in the marketing of food products, slotting is known to exist in other industries and also on the Internet.

My second point relates to the status of research and challenges faced by those studying slotting. Though examined by academics, members of industry and policymakers, our knowledge of this practice is still in the early stages of development. My examination of published studies suggests that research on slotting has largely been devoted to exploratory work and the development of theory. The empirical research that has been conducted has been mainly descriptive, reporting on the form and occurrence of slotting. To my knowledge, only a few studies have conducted empirical tests of theory against information and data acquired in the field.

Beyond acknowledged variation in terminology, interpretation and practice, those studying slotting face considerable challenges. As pointed out in Chairman Bond's opening remarks, most difficult is overcoming the apprehension of some participants to cooperate in discussions or grant access to information and data. Further contributing to this challenge is that many slotting arrangements are verbally negotiated and often go undocumented.

My third point addresses theory and emerging insights for the consequences of slotting. In this regard, research that has been conducted provides some understanding of their effects on competition and consumers. The pro-competitive benefits of slotting are generally explained in two ways depending on how the payments are characterized.

Slotting arrangements thought to be motivated by retailers and imposed on upstream suppliers are explained mainly in relation to the proliferation of new products and their high failure rate. Slotting is theorized to improve the efficiency of introducing and distributing these products.

Slotting arrangements thought to be motivated by suppliers and offered to retailers to assist them in marketing the supplier's products are explained mainly in relation to the rising importance and increasing effectiveness of trade promotion and in-store marketing. Slotting is theorized to improve distribution efficiency, facilitate stronger inter-brand competition and to address free-riding concerns that suppliers have for their marketing efforts.

Theories of anti-competitive harm from slotting focus mainly on how they might be used by retailers and suppliers to distort the competitive process and result in harmful effects for consumers. For retailers, attention focuses on the ability of a dominant retailer with bargaining power over its suppliers to discriminate and charge fees that are unrelated to or in excess of their associated costs. When practiced in this way, concerns focus on the creation of barriers to entry and the potential for increased supplier concentration, lower rates and quality of innovation, reduced variety and choice, and less consumer information that may result.

Additional concern centers on the prospect that the dominant retailer may also face limited competition in its downstream consumer markets. Under such circumstances the concern is that having charged an unreasonable fee the retailer may exercise its market power, keeping the surplus rather than passing it onto consumers in the form of lower prices or applying it in other beneficial ways. Where this occurs consumers can end up paying higher prices and/or receiving fewer benefits than they would but for the slotting.

For suppliers, attention focuses on the ability of a dominant supplier to condition its payments to retailers on the right to exclude, limit or otherwise marginalize rival competitors. Concern centers on the prospect that excluded or disadvantaged suppliers may no longer be in a position to constrain the exercise of market power on the part of the powerful supplier. Some forms of slotting payments may be conditioned on the right to exclude rivals or to simply limit or disadvantage their ability to compete. Where these rights materially raise rivals' costs, they can marginalize existing rivals or deter entry by potential competitors. Costs are raised given the added burden of overcoming the imposed competitive limitation or disadvantage.

In the absence of sufficient offsetting benefits or where such benefits could be achieved in some less exclusionary or restrictive way, slotting arrangements of the kind described can diminish competition and result in harm to consumers. Consumers are harmed where the arrangement enables the powerful supplier to create, preserve or enhance market power.

My fourth and final point addresses recommendations for future research. Let me first applaud this Committee's efforts to appropriate funding for examining slotting practices. Future research that is conducted should first acknowledge the increasing array of trade arrangements and practices that have come to fall under the rubric of slotting. Future research should also emphasize a deeper conceptual and more empirical understanding of slotting.

Data gathered in future studies should in particular include disaggregate or transaction level data that enables researchers to more fully understand the nature of slotting arrangements and how they are conducted. Future research should also focus on the continued development of theory for understanding slotting. Specific efforts should be devoted to slotting that is motivated by retailers and imposed on suppliers. Though considerable anecdotal evidence characterizes slotting in this way, we continue to be challenged to fully understand these arrangements and their effects.

Finally, research should be directed toward understanding slotting in other industries and in particular its emergence in electronic commerce. Though important efforts currently focus on slotting in the marketing of food products, much could be learned through examining its application in other settings.

Thank you, Mr. Chairman, and Members of the Committee.

[The prepared statement of Mr. Gundlach follows:]

"Slotting Allowances and Fees: Research Status, Emerging Insights and Future Directions"

Testimony of
Gregory T. Gundlach
Professor of Marketing
Mendoza College of Business
University of Notre Dame

Before the
U.S. Senate, Committee on Small Business

Hearing on
Slotting Fees: Are Family Farmers Battling to Stay on the Farm and in the Grocery Store

September 14, 2000

Introduction

1. Mr. Chairman and members of the Committee, thank you for your invitation and the opportunity to speak to you today. I am Greg Gundlach, Professor of Marketing in the Mendoza College of Business at the University of Notre Dame located in Notre Dame, Indiana. My research activities address the public policy aspects of marketing practices and have included published studies examining slotting fees within the grocery products and alcohol beverage industries. I have also provided assistance to governmental agencies and private litigants in their attempt to understand the nature and effects of these fees for competition and consumers.

2. My objectives today are fourfold. First, to define the conceptual domain of slotting allowances and fees identifying the basis for varying interpretations and confusion surrounding the concept. Second, to overview the status of research and challenges faced by those studying this practice. Third, to report on theory and emerging insights regarding the effects of slotting fees and in particular those that might be considered anticompetitive and harmful to consumers. Finally, to suggest directions for future research that will permit the development of appropriate public policy.

Slotting allowances and fees

3. Broadly defined, slotting allowances and fees describe payments by suppliers to gain the patronage of downstream channel members. Though originally defining payments to obtain a "slot" in a wholesaler's warehouse for the supplier's products, the term's

meaning has expanded in practice. This expansion has led to varying interpretations and some confusion.

4. Some confine the term to its original meaning. Others use it to also include payments to gain access to retail shelves. Still others use it to refer to an assortment of trade-based payments that range across a product's distribution life-cycle. These include, for example, payments for presentation of a product, access to store shelves, obtaining special displays, staying in the store and being removed from the store. Finally, some consider the term to apply to both new products (including product line extensions) as well as existing products.

5. Different opinions also exist as to what constitutes a slotting fee based on the nature of payment terms. Some narrowly view only payments that are unconditional, fixed in nature, handled off-invoice and paid up-front to be slotting fees. Others view the fees more broadly to also encompass payments that are conditioned on some form of performance, involve variable compensation, appear on invoice, and that are paid over time. Payments involving cash and/or free merchandise are accepted under both interpretations.

6. Opinions also differ as to the characterization of slotting fees as either *imposed* by retailers or *offered* by suppliers or both.[1] Though at times difficult to distinguish, some view slotting fees to refer only to those that are motivated by retailers and imposed on their upstream suppliers. Under this characterization, a supplier would rather not pay the fees but does so given a retailer's advantaged bargaining position. Others, in addition, include payments that are initiated by upstream suppliers and provided to retailers to assist them in marketing the supplier's products. These include payments for merchandising programs, special displays and other promotional efforts.

7. Finally, anecdotal reports suggest that differences are present in the way slotting is practiced across industries. Though the majority of attention has focused on their use in the marketing of food products, slotting fees are known to also exist in other industries. These include the apparel, OTC pharmaceutical, tobacco, greeting card, book and magazine, music CD and tape, computer software, and home improvement products industries among others. Slotting practices have also been reported in the emerging markets for electronic commerce on the Internet This includes sites for B2B communities, technology learning, buying and selling, search engines, online grocers, on-line bidding , consumer shopping portals as well as some wireless communication applications. On the Internet, slotting fees are paid by suppliers to gain access to sites for their products, place information (e.g., banner ads and site links) and to obtain visibility on screens and through pop-up windows.

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1 To simplify discussion, I focus on retailers and suppliers (including manufacturers, producers, etc.). It is well known, however, that wholesalers both pay and receive slotting fees.

Research Status and Challenges

8. Though studied across disciplines, our knowledge of some forms of slotting is still in the early stages of development. Based on my review and understanding, research has been carried out by scholars in economics, marketing, law and taxation. In addition, members of industry including private firms, industry publications, trade association groups, consulting firms, financial analysts and law firms have studied slotting. Policymakers including the Senate Small Business Committee, the Federal Trade Commission, the Department of Agriculture's Economic Research Services, the General Accounting Office, the Bureau of Alcohol, Tobacco and Firearms, the International Trade Commission and other legislative bodies and public agencies have also examined these practices.

9. My examination of published studies and my awareness of legislative and agency initiatives, though not exhaustive, suggests that research on slotting has largely been devoted to exploratory work and the development of theory with little testing of theory through empirical observation. Exploratory work, to date, focuses on the nature and practice of slotting while theoretical work centers on the identification and analytical analysis of slotting's competitive effects. The empirical research that has been conducted has been largely descriptive, reporting on the form and occurrence of slotting. To my knowledge, very few studies have conducted empirical tests of theory against information and data acquired in the field.

10. Understanding slotting is made difficult for various reasons. Beyond acknowledged variation in terminology, interpretation and practice, those studying slotting face considerable challenge in acquiring information and data. Most difficult is overcoming the apprehension of some participants to cooperate in discussions or grant access to firm specific information and data. Some suppliers, particularly smaller ones, worry they may face retribution by retailers should such cooperation be viewed as in opposition to slotting practices. At the same time, some retailers indicate concern for the uncertain policy outcomes that discussions and data on slotting might bring.

11. Further contributing to this challenge is that slotting arrangements are often verbally negotiated and accompanied by few documents. These arrangements often are privately discussed without public disclosure of their terms. The off-invoice nature of some arrangements results in few archival documents that may be relied upon by researchers for information. For accounting purposes, many firms lump common trade payments together, including slotting fees, making them difficult to differentiate.

12. In addition to information and data issues, our understanding of slotting is made difficult due to the lack of developed thought for explaining certain applications of slotting and their effects. For example, in regard to *supplier*-motivated payments, the considerable insight developed to understand the function and effects of exclusive dealing and other related arrangements may be relied upon. This literature provides a clear understanding

of the nature and implications of such arrangements. At present, however, a similar body of thought has not yet fully developed for explaining *retailer*-motivated fees.

13. Indirectly, understanding the competitive effects of all forms of slotting is made difficult because short-term price considerations (based on output) currently dominate modern antitrust policy. Though slotting practices can impact price, they can also effect nonprice dimensions of competition including innovation, choice and variety. Focusing narrowly on price may underestimate the true competitive effects of slotting and their implications for consumers.

Theory and Emerging Insights

14. Research that has been conducted on slotting provides some insight as to its function and effect in distribution channel relationships including implications for competition and consumers. In this regard, the benefits of slotting are generally explained in two ways depending on how the payments are characterized.

15. Slotting arrangements thought to be motivated by retailers and imposed on upstream suppliers are explained mainly in relation to the proliferation of new products and their high failure rate. New product introductions for consumer packaged goods are generally considered to have risen from approximately 2500 products in the early 1980's to over 25,000 in 1998.[2] Failure rates for these products are estimated to be between 80%-90%.

16. In relation to new products, slotting is theorized to improve the efficiency of introducing and distributing products where suppliers use the fees to signal a product's probable success and retailers rely on the fees to screen out product failures. Slotting is also posited to lead to more efficient cost and risk sharing among suppliers and retailers, better shelf-allocation decisions and more effective apportionment of the supply and demand for new products.

17. Slotting arrangements thought to be motivated by suppliers and provided to retailers to assist them in marketing the supplier's products are explained mainly in relation to the rising importance and increasing effectiveness of trade promotion and in-store marketing. Higher costs for traditional "pull" forms of promotion (e.g., mass advertising), diminished consumer loyalty for branded products, a lack of differentiation among new products and a focus on short-term growth has elevated the importance of trade promotion. In addition, studies by the Point of Purchase Advertising Institute (POPAI) suggest consumers are increasingly making many of their brand decisions on location in stores. The effectiveness of trade promotion and in-store marketing is also thought to be on the rise as managers focus more on it.

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[2] Estimates of new products offered to the trade are regularly tracked by both *New Product News* and *Marketing Intelligence Services, Ltd.*.

18. In relation to trade promotion and in-store marketing, slotting is theorized to improve distribution efficiency and facilitate stronger interbrand competition through helping suppliers to gain retailer cooperation for their marketing and promotional strategies. These payments are also posited to induce retailers to avoid "free-riding" and address other concerns that suppliers have for their marketing efforts.

19. Theories of anticompetitive harm associated with slotting focus mainly on how they might be used by powerful retailers and powerful suppliers to distort the competitive process and result in harmful effects for consumers. Two theories have received increasing, yet disparate attention. For retailers, these concerns are those generally associated with theories of "monopsony" and more particularly "*buyer power*." For suppliers, these concerns are those associated with theories of "monopolization" and more particularly "*exclusion*." To date, enforcement attention has centered on exclusion although considerable concern has been voiced by suppliers with regard to buyer power.

20. **Buyer Power**. For retailers, attention focuses on the ability of a dominant retailer with bargaining power over its suppliers (e.g., buyer power), to discriminate and charge unreasonably high slotting fees and the implications of such conduct for competition and consumers. In some markets, as a result of increasing consolidation, improvements in technology and the development of successful private labels (i.e., store brands), retailers have acquired increasing bargaining power over their suppliers. These retailers are able to extract concessions from suppliers that they could not under more competitive circumstances, including high slotting fees.

21. Where powerful retailers are able to impose their bargaining clout on suppliers and charge slotting fees as just described, barriers to entry may be created. Some suppliers may be unable to secure the necessary capital to pay the required fees. Other suppliers may have to raise their prices or lower their expected profits to pay them. Smaller suppliers may be disproportionately affected where they have to spread the cost of the fees across less volume and fewer product lines. These suppliers may also not be able to raise their prices against powerful retailers. Over time, where high enough, the cost of the fees may push returns for some suppliers below their minimum viable scale forcing them to opt out of the market.

22. Retailers may also face challenges. Smaller retailers may find it more difficult to charge the same fees or obtain the lower prices that their larger rivals can. Over time, their costs may be raised resulting in similar disadvantages as their upstream counterparts.

23. Competitive concerns for the consequences of slotting focus on the increased supplier concentration, lower rate and quality of innovation, reduced variety and choice and diminished consumer information that may result where they are practiced in the way described. Fewer suppliers may lead to higher levels of concentration and the potential for collusion. With fewer suppliers competing, the rate and quality of innovation may also be adversely affected. Fewer firms may also result in fewer options being offered to the market, limiting variety and constraining choice. Finally, the allocation of

promotional dollars to pay slotting fees may take away from more information-based consumer promotion.

24. Additional competitive concern focuses on the resultant effects of slotting for consumer prices and/or services. Particular attention centers on the prospect that a powerful retailer, with substantial bargaining power over its suppliers may also face limited competition in its consumer markets. Under such circumstances, the concern is that the retailer, having charged suppliers an unreasonable fee, may exercise its market power, keeping the surplus rather than (1) passing it on to consumers in the form of lower prices or (2) applying it in other ways that benefit them. Where this occurs, consumers can end up paying higher prices and/or receiving fewer benefits than they would but for the slotting.

25. Although the same concerns can arise where powerful retailers choose to not pass on to consumers the savings they obtain from price discounts, some slotting arrangements are thought to provide certain advantages to retailers. First, compared to price discounts, receipts from *off-invoice* slotting payments are less visible to rivals and other suppliers. This enables retailers to more easily charge different suppliers different fees (i.e., to discriminate among suppliers). Second, *fixed fee* or lump-sum slotting payments may be treated as "other revenue" thereby providing greater accounting flexibility. Price discounts normally appear as reductions to cost of goods sold and affect the calculation of gross margin. "Other revenue" is treated separately, providing greater flexibility in accounting for the use of these payments. Third, payments of slotting fees that are *unconditional* (e.g., not conditioned on some form of performance), provide added operational flexibility. Unlike price discounts that may be contingent on some form of performance (e.g., functional discounts or other conditional incentives), a retailer is free to apply unconditional slotting payments as they choose. Finally, *up-front* slotting payments provide advantages in terms of the timing of cash flow. Though price discounts lower retailer costs, up-front slotting payments provide retailers with a ready source of funds. In combination, slotting arrangements of the kind just described may be found by some retailers to be more advantageous than price discounts.

26. **Exclusion**. For suppliers, attention centers on the ability of a powerful supplier to condition its payments to retailers on the "right" to exclude, limit or otherwise marginalize rival competitors and the implications of such conduct for competition and consumers.

27. Competitive concerns focus on the creation of barriers to entry, the resultant potential for increased supplier concentration, collusion and the exercise of market power. Additional concerns for innovation, variety and choice are also noted. Attention centers on the prospect that excluded or disadvantaged suppliers may no longer be in a position to constrain the exercise of market power on the part of the powerful supplier, resulting in diminished competition and higher downstream prices to consumers.

28. Some forms of slotting payments may be conditioned on the right to exclude rivals or to simply limit or disadvantage their ability to compete. Where the payments enable the supplier to exclude rivals altogether, they mirror traditional "exclusive dealing" arrangements. Other arrangements may grant the supplier the right to limit rivals' access, placement or visibility in the store or to otherwise disadvantage their marketing efforts at the point of sale. In some cases, powerful suppliers may obtain such rights as part of their category management activities.

29. Where these rights materially raise rivals' costs they can marginalize existing rivals or deter entry by potential competitors. Costs are raised given the added burden of overcoming the imposed competitive limitation or disadvantage. Though other retail outlets and other options for promotion might be available, they may be more costly and less effective. The available outlets may be more difficult to serve and/or yield lower levels of volume. The promotion alternatives may have higher costs and/or generate less demand. Faced with such disadvantages, potential entrants or incumbents may be unable to establish or maintain adequate investment and/or promotion incentives to remain competitively viable.

30. In the absence of sufficient offsetting benefits (e.g., distribution efficiencies, enhanced interbrand competition, and/or the address of free-riding concerns) or where such benefits could be achieved in some less exclusionary or restrictive way, slotting arrangements of the kind described can diminish competition and result in harm to consumers. Consumers are harmed where the arrangement enables the powerful supplier to create, preserve or enhance market power. Retailers may agree to go along with the use of slotting in this way because they are sufficiently compensated, influenced or find it advantageous for other reasons.

Directions for Future Research

31. In terms of guidance for research, several recommendations may be identified.

32. Future research should first acknowledge the increasing array of trade arrangements and practices that have come to fall under the rubric of "slotting." Though consensus is unlikely it should also not be the intended objective. Researchers should strive to focus on the phenomenon broadly and not be bounded by existing labels and terminology. To do so may limit our understanding of their true effects and also limit our awareness of related practices that might be of interest.

33. Future research should also emphasize a deeper conceptual and more empirical understanding of slotting. While exploratory empirical efforts have provided some knowledge of their nature and use, further comprehension of slotting is required. In particular, though theory has been developed and applied to understand the effects of slotting in particular instances, the lack of extensive empirical efforts to test these theories precludes their widespread generalization. The data gathered in future studies should include aggregate data, but most importantly disaggregate or "transaction level" data that

enables researchers to more fully understand the nature of slotting arrangements and how they are conducted.

34. Future research should also focus on the continued development of theory for understanding slotting. Particular efforts should be devoted to slotting that is motivated by *retailers* and imposed on suppliers. Though considerable anecdotal evidence characterizes slotting in this way, we continue to be challenged to fully understand these arrangements and their effects. As a result, public policy efforts and legal challenges have tended to center on slotting from the perspective of those arrangements that are motivated by *suppliers* and employed to exclude their rivals. More specific effort should be dedicated to understanding the use of slotting by retailers and its effects for competition and consumers.

35. Finally, future research efforts should also be directed toward understanding slotting in other industries and in particular its emergence in electronic commerce. Though important efforts currently focus on slotting in the marketing of food products, much could be learned through examining its application in other settings. Slotting's emergence in electronic commerce is particularly interesting both from the perspective of how it is used and the special issues raised. Focusing on its application in this unique context is critical given the increasing level of e-commerce business.

Conclusion

36. Slotting allowances and fees continue to raise challenging questions. Further research on this practice is needed and should be undertaken in order that the appropriate public policy response may be obtained. I applaud the committee's interest and ongoing efforts in this respect.

37. Thank you Mr. Chairman and members of the Committee.

Chairman BOND. Thank you very much, Professor Gundlach.

Let me ask Mr. Dyckman. The GAO has in the past successfully obtained confidential information from other industries; has it not?

Mr. DYCKMAN. Yes, on a case-by-case basis we have had some success, for example, in the airline industry and then in the defense industry. Frequently it depends on whether or not the contractor or the private firm has some interest in cooperating with us but we have had some success stories; that is correct.

Chairman BOND. And have the confidentiality agreements worked well? Have you had any problems with information that you have been turned over, proprietary information leaking out?

Mr. DYCKMAN. Not to my knowledge, sir.

Chairman BOND. How does the cooperation you have experienced in that area compare with, I would use the word cooperation lightly, but the relationship you had in these industries?

Mr. DYCKMAN. As you know, Sir, we do not have the information that you desire. We went to the associations. We made a good faith effort. We explained to them and they knew quite well that we did not have authority but we made certain assurances to them. You went out of your way to write us a letter giving a pledge of confidentiality.

They told us they contacted some of their members. One of the associations e-mailed 55 of their members or so. They did not encourage their members to cooperate with us. So I think without encouragement from the associations it would have been very difficult, and we anticipated that quite frankly. I have worked for GAO for 31 years and this is the first time I have had to report to a committee that I have been unsuccessful in trying to carry out the work. So we do not feel fulfilled.

As you said in your opening statement we gave it our best efforts, but without the cooperation of the industry we could not carry this out.

Chairman BOND. Thank you very much, Mr. Dyckman. Ms. Offutt, it is clear from your testimony that payments, up-front fees have been increasing. Is this practice increasing over recent years?

Ms. OFFUTT. Yes.

Chairman BOND. You mentioned something that struck me. You mentioned in the competitive marketplace, in the real competitive world—we all like to think there may be a real competitive world out there—that these prices would result in lower prices that the consumer would pay because obviously there would be competition. Do you have any evidence that these payments have, in fact, lowered fees, the ultimate price that consumers pay at retail?

Ms. OFFUTT. We did not look directly at evidence that would have suggested that, for instance, a fee paid for an advertising campaign, to advertise a sale, actually resulted in lower supermarket prices or actually induced people to buy more. We did not ask for that kind of transaction data from the retailers.

Chairman BOND. You suggest, in your written testimony, that the study did not review how the increased incidence and magnitude of fees effects growers. Based on what we have heard here today can we expect you all to pursue this question and look to the impact it may be having on growers?

Ms. OFFUTT. Yes.

Chairman BOND. Did you review any individual markets to see the competitive impact generally?

Ms. OFFUTT. In the third stage of the study we are going to look more directly at the question of whether or not the practices are having anti-competitive effects. The study that we are completing now that I spoke about this afternoon is what was referred to as a more descriptive approach. What are the fees? How are they incurred?

But it does not actually allow us to draw a judgment about their harmful or beneficial effect. It just gives us the basis for going on to ask more.

Chairman BOND. We need that basis and it seems to me that we have outlined a pretty clear area for inquiry here because I think certainly the testimony we have had today, the testimony that was presented to the FTC indicates there are potentially some very serious problems. Did the economic research service run into any of the problems that the GAO encountered in finding—you said you talked only about shippers or retailers willing to talk about the practices and about the fees?

Ms. OFFUTT. Yes, we did. We had on both sides shippers and retailers, people who were not interested in speaking with us at all. Some were more forthcoming about the nature and the size of fees but I think it is fair to say overall the retailers were less forthcoming than shippers were in answering our questions. And really we got very little of the kind of detailed transactions data that you have to have to make these determinations of benefit and harm.

Chairman BOND. As I stated at a previous hearing, in one of my prior lives I was an antitrust attorney working on the Robinson-Patman Act and related matters. I know how much fun it is to compile that kind of information. Nevertheless, it seems to me that that could be critically important and I would hope that the Economic Research Service would pursue the information and the impact that this has on growers as well as those down the line and ultimately the consumers. Are the consumers getting any better deal, or are they simply losing choices that should be available to them?

Professor Gundlach, while we are speaking about that, you talked about some of the considerations. Based on your review what kind of antitrust laws or consumer protection laws might be called into play here? Talk about having additional laws. Do you think, No. 1, are there adequate laws and what would they be and what, based on your experience, might be needed from here?

Mr. GUNDLACH. Mr. Chairman, I hesitate to make a comment regarding the nature of laws that might apply to the specific practices that we are talking about. Though I do have a legal background, my expertise is more in the behavioral aspects of the fees and how they might have implications for competition. So I respectfully would not like to answer that question, if I may not.

Chairman BOND. OK. I will throw out a few, in addition to the Robinson-Patman Act, sections I and II of the Sherman Act, section V of the FTC Act, the Clayton Act. It sounds like there are some good weapons out there but based on your study with the growth of these slotting practices what would you say the future holds for the small grower in this instance or, more broadly, the small manufacturer who is seeking access to retail shelves?

Mr. GUNDLACH. If I can take a step backwards, I think that slotting is really symptomatic of the confluence of three distinct forces. One of those forces has been spoken of today and that is the shift of power that has occurred in many of our distribution channels into retailers' hands. The second force is the proliferation of new products and the third force is the increasing importance of trade promotion. All of those are coming together in terms of their effect on slotting.

In terms of what the future holds, at the present rate of progress slotting will make it very difficult for small, independent and those suppliers without resources, overcome some of the barriers that these forces have brought forth. Particularly that these fees will provide high-entry barriers for smaller firms.

Chairman BOND. And what is your analysis of the impact that those fees themselves may have and the results of those fees in limiting access of smaller manufacturers have on the choices available to the ultimate consumer? When the consumer goes into the marketplace, does she have fewer choices? When I go into the marketplace, am I cut out, likely to be cut out of having an opportunity to buy a better quality product at a lower price?

Mr. GUNDLACH. To the extent that they do create barriers to entry for firms that would offer higher-quality products—more innovative products in the marketplace, I do think they create challenges of choice. These challengers are not only in terms of the options, but in the process of choice that consumers have. While smaller suppliers may be able to find access to consumer markets through other forms of distribution, these challenges will raise the costs to consumers of having to seek out these other forms of distribution to secure the options and variety that they desire.

Chairman BOND. Thank you very much, Professor. We have been joined by my colleague and Ranking Member, Senator of Massachusetts, Senator Kerry. Welcome.

OPENING STATEMENT OF THE HONORABLE JOHN F. KERRY, RANKING MEMBER, COMMITTEE ON SMALL BUSINESS, AND A UNITED STATES SENATOR FROM MASSACHUSETTS

Senator KERRY. Mr. Chairman, thank you very much. I apologize to you and to all the panelists for not being able to be here sooner. I personally started the ball rolling on the issue of slotting fees over a year ago, and I wanted to participate in the entire hearing. But today has been one of those exceptionally conflicted days around here and I apologize for that. On the other hand my able staff has been here throughout and I look forward to reviewing the Record when it becomes available.

The practice of charging slotting fees, in my judgment, is highly questionable. The industry's conduct and its unwillingness to cooperate fully with the efforts to understand the use of slotting fees has effectively invited Congress to put the practice under a microscope in order to determine to what extent it does effect small businesses and consumers. I want to thank you, Mr. Chairman, for your significant and genuine interest in this and for your significant collaboration in it. I think that your own experience as an AG and your experience as a Governor have prompted you to be automatically tuned in to what this means. In a free-market system, which we pride ourselves on having, this practice does not seem right, nor does it smack, at least on the surface, and I emphasize on the surface, nor does it smack of normal free-market practices to know that somebody could have a really rather extraordinary product, but be very small and not have the power to be able to get their product to consumers. Even though it could conceivably cost significantly less and be a better product.

Now, conceivably, just as a cost of doing business, like franchising costs, it might, conceivably under some readily interpretable, clear fairly arrived at and accessible system, be a cost that people who manufacture something need to factor into their cost of goods and ultimately pass onto the consumer. But, that does not appear to be what we are seeing here. Neither accessible, nor rational, nor clear, and most importantly, instances that we have had reported to us by individual small retailers which appear to be on many occasions spontaneously arrived at, perhaps in some cases even without the knowledge of upper management or of corporate headquarters. Though that does not appear to be true in cases involving chains. But, there are instances where we have seen a form of creative entrepreneurial effort engaged in by people who happen to control the access to those shelves.

So, there is a lot going on here. And frankly, as I said earlier, it invites an even greater level of scrutiny and much more suspicion that we are having trouble getting answers. There have been a number of retailers that I have talked to privately, and I have heard all kinds of horror stories, which I could repeat, and some of them have been repeated, but they will not go public. And the reason they will not go public is pretty clear. I mean the capacity for being blackballed and for suffering economic injury as a consequence, particularly in a world where they do not quite know how far Congress is really going to go here? What is the sustainability of Senator Bond and Senator Kerry and the Small Business Committee's interest in this? How far will this go? So if we go public a year from now, their interest may weigh in and they get burned. I understand that.

And so it is important for us to be very clear about the sustainability of this effort and our efforts to try and understand it. I have not talked to the Chairman about this yet, but maybe this is something that is more perfectly suited to the Permanent Subcommittee on Investigations, which might be able to be of greater assistance to the GAO and/or the FTC in their efforts to pursue it.

I do not know the answers to these questions. I did not come here with a predetermined outcome, but in the absence of our ability to be able to create a rationale and an understanding of this, and in the face of increasing reports from people who testify as they have today and on other occasions about an uncooperative industry, we need to understand it better.

So my message today, I am not going to ask questions of the panel because I do not like coming in late and being repetitive, but as I said I will review this record carefully.

I first raised the issue because a businessman in the Midwest told me how his business had suffered time and again because he was hit with onerous fees to sell his product instead of another brand. Rather than both brands competing fairly, even when there was shelf space for both and even when his brand was selling well—making money for the business and he was filling repetitive orders based on consumer demand—he was forced to pay fees to get his product on the shelves. And that sparked my interest because it just did not seem right. It did not seem fair. It did not seem consistent with the concept of this Committee's commitment to help small businesses thrive.

So, Mr. Chairman, I thank you for your energy and effort. And I hope, clearly, that the FTC and the GAO will be able to complete their task. For those out there who are fighting this practice, our message to you really is come and talk to us. Help us to understand. We have proven our ability, to maintain anonymity. We have proven our ability, I believe, to maintain even our interest and we will do so as we go down the road. Thank you, Mr. Chairman.

[The prepared statement and attachment of Senator Kerry follow:]

Statement by John F. Kerry
Ranking Member, Committee on small business

"Slotting: Are Family Farmers Battling to Stay on the Farm and in the Grocery Store?"

September 14, 2000

Good morning, and welcome to the Committee's second hearing on the business practice of charging "slotting" fees. Except as it applies to actual promotional activities which increase sales, this practice is highly questionable. The industry's conduct, and unwillingness to cooperate fully with efforts to understand the use of slotting fees, has effectively invited Congress to put the industry's practices under a microscope to determine to what extent it affects small businesses and consumers.

Mr. Chairman, as I said at the first slotting hearing last year, I genuinely appreciate your openness and commitment to working with me to get to the bottom of this practice. I just couldn't ask for better collaboration on this issue.

We pride ourselves in this country on our commitment to free and open competition. We pride ourselves on being a model to every country that wants to embrace a free-market system. And this Committee prides itself on trying to guarantee the small entrepreneur a fair shot. That requires fairness in the marketplace — fair competition. There is a legitimate question to be answered as to whether slotting fees are fair. We are trying to answer that question through our hearings, through the General Accounting Office's efforts, through the Federal Trade Commission's study, through whatever tools it takes to understand this issue.

At first we thought this practice might be limited to the dry goods industry and companies trying to get their products on the shelves of grocery stores.
Now, a year later, we know it is more prevalent and extends to fruits and vegetables. Just like I want fair competition, I also want a constructive and fair analysis of slotting allowances to determine to what extent, if any, they are harmful. Again, are slotting allowances anti-competitive for businesses? Do these practices empower large businesses to impede the capacity of small businesses to gain their fair access to the market? Are slotting allowances anti-consumer? Do the fees lead to competition that benefit the customer with better prices and higher quality products? If this practice is beneficial and fair, as some in the industry claim, why are the fees, often tens of thousands of dollars paid to a retailer, not recorded in normal bookkeeping? Why are they in cash? Why do manufacturers write off the cost, but retailers don't claim the payment?

I first raised this issue because a businessman in the mid-west told me how his business had suffered time and again because retailers hit him with onerous fees to sell his product instead of another brand in their stores. He had to "pay to play," if he wanted to sell his product. He said the practice was pervasive throughout the food industry but that smaller companies were too vulnerable, and therefore terrified and paralyzed, to talk about it on the record -- they are under a defacto gag rule. I empathize with these entrepreneurs, but I am frustrated because without their testimony and cooperation, it is next to impossible to fully identify the practice and to determine appropriate intervention. It's a classic catch 22.

That brings me to the second part of this hearing, which will focus on the serious lack of information and data on this practice and its impact. Though the results are disappointing, I really appreciate the work this Committee, the FTC, and the GAO have done to contact businesses and build a record on slotting. I commend the FTC for holding a workshop on slotting. We got some really good information out of that forum. I also think the FTC's testimony in the House Judiciary Committee last year is important to what this Committee is trying to accomplish. To that end, Senator Bond and I sent a letter to the Chairman of the FTC, Bob Pitofsky, asking him to submit the hearing testimony and transcript from the workshop to the Committee so that we could include it in the record for today. It is hard enough to get information about slotting without having to track down what information already exists. So, I think Senator Bond and I have made the right decision to put it all in one place, and I ask that a copy of the letter be included for the record.

Of course, it would have been better to have the FTC testify, but that was impossible because it could jeopardize on-going litigation. I think we all respect that decision.

In that same letter, we asked the Chairman about the timing of the Commission's preliminary report on the workshop it held. Understandably, we are anxious to see what the FTC has to say and would like to know we can expect to get a copy.

In closing, I ask all businesses affected by the practice of slotting to tell their story, if they are interested in a fair shot to sell their products or produce. You are our eyes and our ears. We need to hear from you.

Mr. Chairman, thank you for working with me on this issue.

United States Senate

COMMITTEE ON SMALL BUSINESS
WASHINGTON, DC 20510–6350

September 12, 2000

VIA FACSIMILE (202/326-3585)

The Honorable Robert Pitofsky
Chairman, Federal Trade Commission
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

Re: Submission for Slotting Hearing on September 14, 2000

Dear Chairman Pitofsky:

As you know, the Senate Committee on Small Business is holding its second slotting hearing, "Slotting Fees: Are Family Farmers Battling to Stay on the Farm and in the Grocery Store?", this Thursday. Though the Federal Trade Commission (Commission or FTC) is unable to testify because it could jeopardize on-going litigation, we think the Commission's knowledge of slotting is important to identifying for Congress the impact of this practice on small businesses. To that end, we are interested in knowing when the Committee can expect to receive the FTC's preliminary report on its on-going study of slotting practices. In addition, we would like the Commission to submit the following two documents for the record:

1. Testimony from a hearing in the House Committee on Judiciary, October 20, 1999.
2. The transcript of the FTC public workshop on May 31 and June 1, 2000 (Matter No. P001201).

As always, thank you for your assistance. If you have any questions, please do not hesitate to call either of us, or have your staff contact Paul Conlon with Senator Bond, at 202-224-5175, or Patty Forbes with Senator Kerry at 202-224-8497.

Sincerely,

John F. Kerry
Ranking Member

Christopher S. Bond
Chairman

Chairman BOND. Thank you very much, Senator Kerry. Thank you for your initiative and support for this effort and for the authority that you bring to our efforts.

A couple points you mentioned, we have been able to gather information from many aggrieved parties by slotting. If you will contact this Committee, we can assure you of confidentiality in hopes of learning more.

Second, under transparency I would only reiterate what the Senator from Massachusetts said. One of the first things you want to know about this process is if it is justified, if it is reasonable, if it is necessary and economically beneficial, why in the dickens is it kept so secret? That, more than anything else, makes us suspicious. If you have got a good justification, why don't you lay it out? If it is the best thing since sliced bread, why isn't somebody willing to talk about it? That is why the lack of transparency as discovered by the GAO and by our continuing efforts makes it highly suspicious.

Third, you mentioned the Permanent Subcommittee. I had an opportunity to talk with Senator Collins of Maine about this today. She had been approached by a number of produce farmers from Maine and I think that this may be a good area for us to refer to the Government Affairs Committee for their work and assistance on this as well so they can continue to help us.

But I want to thank all of our witnesses for taking time out of a busy schedule to attend today. I know we have a number of produce farmers in the audience who are here and taking time out. If you choose to do so, would you hold up your hands so we can see who is here? Thank you all very much. We will only take pictures of the backs of your heads. We appreciate very much your coming. It has been an informative hearing.

There is clear evidence of a very disturbing impact on small produce farmers from these fees. The use of fees raises numerous issues, not the least of which is why the fees may be necessary. It is unfortunate that the industry representative did not appear today. We will be asking them to explain why they chose not to and why if the process is such a good one, they are not willing to defend it.

We again note there has been much work done on slotting allowances, including increased attention by the FTC. We would urge our friends at the FTC to give careful consideration to analysis of this practice and determine the competitive or anti-competitive effects. We, as I said, intend to follow up with the FTC and we have urged, at this point have included in the Senate mark on the Commerce, Justice, State, and the Judiciary Committee's Appropriations bill $900,000 for them to do further work in this area. We intend to follow up with them to assure that that additional money, if we can get it to them, will be used to collect the data, establish guidelines and take such other necessary steps.

I would urge the ERS to continue and expand upon its work as well. Professor Gundlach, we will look forward to hearing from you, and your continuing analysis. Finally, for anyone who does have information, we would ask that you forward it to the Small Business Committee.

I thank all witnesses and those who are here in the audience today for joining us. We obviously are going to continue to be revisiting this as long as this practice remains widespread, and particularly if it remains hidden from view, we are going to continue to do our best to see that it is brought out in the open. Thank you very much. The hearing is adjourned.

[Whereupon, at 2:40 p.m. the Committee was adjourned.]

APPENDIX MATERIAL SUBMITTED

FOOD MARKETING INSTITUTE

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October 16, 2000

The Honorable Christopher Bond
Chairman
Committee On Small Business
Unites States Senate
Washington, DC 20510-6350

Dear Chairman Bond:

The Food Marketing Institute (FMI) is pleased to provide responses to the questions submitted following the Committee's September 14 hearing on slotting allowances. The responses are attached. In addition we want to take the opportunity to clarify certain other issues that have arisen in connection with the hearing. We respectfully request that our answers, along with this letter, be placed in the record of the hearing.

FMI was unable to provide a witness for the hearing because of scheduling difficulties. The hearing was scheduled on short notice (about two weeks), apparently to coincide with a meeting of the produce industry being held in Washington. I was scheduled to be out of town that day as was Tim Hammonds, FMI's President and CEO. Tim and I had both testified previously on this issue. When we advised staff of our scheduling difficulty we were told quite clearly that it was not a problem for the committee if we did not testify. While we knew we would be missing an opportunity to explain the issue further, we were given no indication that so much would be made of our absence. Perhaps we should have known better given prior experience.

As noted, I did testify for FMI at the September 14, 1999 hearing on slotting allowances. In preparation for the hearing FMI had extensive meetings and conversations with committee staff. We were advised that the hearing would be a neutral, straight-forward attempt to develop the facts about slotting. We advised staff that our witness would be a representative from a prominent, well-respected company from the Chairman's state. That individual was then called and told that the hearing would be hostile and that it might be better for the trade association to represent the industry. This was the first indication we received of the nature of the hearing. Our witness took the Committee's advice and I testified instead. I have to say that in all my years in Washington and experience testifying before Congress, I had never heard of anything like this before. At the hearing opponents of slotting testified in hoods, behind screens and with their voices distorted, allegedly to prevent retribution. While the media was alerted to these theatrics, FMI was never advised by staff that this would occur.

The Honorable Christopher Bond
October 16, 2000

Subsequent to that hearing, FMI invited committee staff to attend a meeting of a member committee in December of 1999. They were unable to attend. An invitation was extended to staff to attend our annual convention in May of this year. At our convention (which is attended by 35,0000 industry members) the exhibit floor is filled with suppliers of thousands of products that are used and sold in stores. Special attention is always given to the new products being brought to market. This convention provides a wonderful opportunity for anyone interested in the process of getting products on store shelves and to the consumer. Unfortunately staff could not attend.

Over the last two decades, FMI and industry members have participated in many other forums where slotting has been a topic. Last October the House Committee on the Judiciary held a hearing on slotting. Tim Hammonds, FMI's President and CEO testified. Tim and I, and others on our staff, have done many newspaper, TV and radio interviews on the subject. This spring, FMI counsel and several member companies participated in the Federal Trade Commission (FTC) workshop on slotting.

I know that the Small Business Committee actively encouraged the FTC to conduct this workshop and we believe it was very productive. The FTC was successful in bringing together a broad spectrum of industry witnesses on all sides of the issue to participate in the two-day session. It is noteworthy that the FTC was able to find a number of individuals who were willing to publicly criticize slotting and to recount their experiences. Likewise individuals from large and small retailers, wholesalers and club stores participated. We believe that these two days of public discussion provided for a much fuller understanding of the issue than any brief congressional hearing could . We commend the transcript, which is available on the FTC's web site, to your attention. We look forward to any conclusions or recommendations that the agency may develop as a result of the workshop.

In conclusion, Mr. Chairman, we recognize that to this point we have been unable to explain slotting and the context in which it occurs to your complete satisfaction. However, it is not for lack of trying. We look forward to continuing to work with you and the committee on this and other issues

Sincerely,

John Motley
Senior Vice President
Government and Public Affairs

Enclosure (1)

Responses To The Questions For The Food Marketing Institute

1. **Why were none of the Food Marketing Institute's (FMI) member companies willing to provide access to their records to the General Accounting Office (GAO) investigators that were studying the use of slotting allowances in the retail grocery industry?**

Decisions concerning the extent to which FMI members provided information to the GAO investigators were strictly those of the individual companies. We cannot speak to the reasons for any individual company's decisions in this regard because we do not know them. We know that some companies were concerned about the inability of GAO to guarantee the confidentiality of the data and documents it was seeking.

We are also aware that some members doubted that the GAO would conduct an objective study. These members knew that the study was being conducted at the request of the Small Business Committee. In their view, the Committee's September 14, 1999 hearing was high theater and had treated the supermarket industry unfairly. In addition, public comments from the committee leadership and staff had led them to believe that the Committee was engaged in a media exercise and was not interested in objective facts.

As a result of FMI's efforts, two member companies did meet with GAO at their facilities and spent a good deal of time with agency staff, at what they felt were very productive meetings. GAO's characterization of those meetings in its report is disappointing and telling. First it describes the companies dismissively as "two mid-size grocery chains." One of these chains is a $2 billion dollar company and the other is part of a $20 billion company. These two companies operate in different regions of the country and anyone familiar with the industry would know that GAO was receiving the cooperation of industry leaders. Moreover, GAO reports that "neither provided...specific information about the use and accounting for slotting fees in their business." Both companies report that they did just that, providing detailed explanations of their "use and accounting" for slotting. Both companies were given the impression that the agency had learned a good deal of useful information at the meetings.

2. **How extensive were FMI's efforts to seek the cooperation of its member companies with the GAO's examination of this issue?**

3. **How many members and what percentage of its members did FMI contact about cooperating with the GAO in its review?**

4. What criteria did FMI use to identify member companies that may have been willing to cooperate with the GAO?

FMI communicated the GAO request to two member committees, made up of individuals that would normally deal with these types of requests from government agencies. Both these committees consist of a representative group of companies, made up of large and small retailers and wholesalers from all regions of the country. FMI encouraged cooperation to the extent individual companies were comfortable because we anticipated criticism if there were no cooperation and because we believe that there is a positive story to share on this issue.

5. Why did it take a long period of time to identify only two companies that would speak to GAO investigators?

We are not aware that it took a "long" period of time to identify companies. FMI first met with GAO in January, but we did not receive the Chairman's letter on confidentiality until the FTC hearing at the end of May. At that meeting we advised the agency that FMI's information service was a valuable resource for finding factual information about the industry. To our knowledge, GAO never used that resource. If they had, they would have found a number of publications with names, addresses, phone numbers etc. of retailing and wholesaling companies in every marketing area in the nation. Many of these companies are not FMI members. We do not know if GAO made any independent effort to contact and survey the industry. We also do not know if it contacted other industry associations, either federal or state.

6. Why did the pledge of confidentiality from the Committee on Small Business (Committee) not make a difference in gaining the cooperation of FMI's member companies?

7. What steps need to be taken to ensure that FMI's member companies will cooperate with the GAO or other Federal agencies in future inquiries and provide documentation on the use of slotting fees?

Once again, we can not speak for individual companies on this matter. We do know that the industry tries to cooperate with all government agencies on all issues. Concerning slotting in particular, the industry has cooperated with many investigations over the years. Professor Gregory Gundlach, who testified at the hearing and at the recent FTC workshop, reports that 285 retailers responded to his survey on slotting. FMI has been actively cooperating with the US Department of Agriculture in its ongoing investigation of slotting and the industry has been cooperating with the FTC in its study of the issue. A number of industry members, including large and small supermarket operators, wholesalers and a warehouse store participated in the recent FTC workshop along with several economists and consultants familiar with the distribution process. These participants were very forthcoming and we commend the transcript of the workshop, available on the FTC's web site, to the committee's attention. The FTC workshop was an objective exercise aimed at learning the facts and applying them to the law. Many in the industry see the Committee's activity in sharp contrast. Because of the nature of the September 24,1999 hearing, they believe the Committee already had its mind made up, was conducting a media focused political exercise and was not interested in the other side of the story.

As noted previously, another reason for the perceived lack of cooperation is that neither the GAO nor the Committee could guarantee confidentiality. The Chairman's letter did indicate that the Committee would not disclose specific information, and said that he would encourage other members of congress not to request the information. Some companies did not believe that was sufficient. It is not unheard of for confidential information to leak from congressional sources and the Chairman, though well-intentioned, could not guarantee that the information would not become public.

We cannot state with any certainty what steps would "ensure" cooperation and that documents would be provided in the future. However, we dispute the characterization that the industry did not cooperate with GAO. As noted above, FMI and at least two prominent well-respected companies spent extensive time with GAO staff, providing a great deal of background, which they lacked, about the food marketing system and giving them detailed information about slotting. We have been advised that our members felt the meetings were positive and productive for the agency.

8. Please explain how slotting fees differ from the use of "payola" in the recording industry?

Slotting fees are not in any way, shape or form "payola." As we understand that term it refers to under the table payments of money or other items of value to disc jockeys in exchange for which records were played over the air. Some opponents of slotting have attempted to compare slotting to payola, but that comparison is false. Of course, secret payments to buyers for their personal gain to influence their purchasing decision should be, and *are*, illegal and should be prosecuted under existing commercial bribery statutes. Slotting fees, which have been a common feature of the marketplace for more than a quarter of a century, are more akin to advertising or other promotional allowances. As Professor Gundlach testified at the September 14 hearing, slotting exists in many other industries, including apparel, pharmaceuticals, tobacco, greeting cards, books and magazines, music CDs and tapes, computer software and the home improvement industry.

A form of slotting is fundamental to the emerging e commerce market. As Professor Gundlach states "On the internet, slotting fees are paid by suppliers to gain access to sites for their products, place information (e.g. banner ads and site links) and to obtain visibility on screens and through pop-up windows." We have not heard anyone suggest that web site providers offer free space for such access to their sites. Conceptually, it is difficult to understand why fees for access to cyberspace are acceptable, but fees for shelf space are not.

9. Please explain why Congress should not enact legislation requiring the disclosure of documentation from FMI's member companies on slotting fees, if the Committee and Federal agencies are unable to acquire documentation on slotting fees from such member companies on a voluntary basis.

We believe that such legislation is unnecessary and would be counterproductive. Slotting allowances are not new. They have been common in the grocery industry for a quarter of a century. They are used in many other industries and are fundamental to the growth of e-commerce. (See question 8.) As the FTC has stated on many occasions, they are legal and pro-competitive. (See questions 10 and 11.) The market is working in an unprecedented fashion, encouraging innovation and consumer choice. Anyone who thinks otherwise must not have been in a supermarket recently. Fifteen thousand new food and grocery products reach consumers each year, including many new fresh produce products. And new forms of competition emerge continually, allowing suppliers to distribute their products through mass merchants, club stores, convenience stores, drug stores, specialty stores (Starbucks and the like) mail order and the internet. In these circumstances there is no reason for the government to intrude in a competitive system that is working for the benefit of our nation's consumers. New regulation and record keeping requirements will only serve to raise costs and prices and to protect entrenched suppliers from new competition.

10. The primary rationale provided to the Committee by FMI's representative, John Motley, for slotting allowances at the September 14, 1999, hearing is that such fees are a risk-sharing mechanism that reflect the actual costs of retailers for the failure of new product introductions. In its most recent hearing on slotting allowances, the Committee heard from the presidents of three associations, representing approximately 90 percent of the produce shippers and growers, that the practice of charging slotting fees and other similar fees for loose fruits and vegetables is escalating. Is this practice escalating and what is the rationale for your members companies to charge these fees on loose fruit and vegetables that already have significant consumer demand?

Slotting fees are an issue because of the scarcity of shelf space. The typical supermarket stocks some 30,000 items and there are well more than 100,000 to choose from. Recently, about 15,000 new products have been introduced each year. More then 90 percent of these fail within the first year. If shelf space were infinite, every supplier could get shelf space and there would be no problem. But it isn't. Difficult decisions have to be made. In our testimony at the September 14, 1999 hearing we explained in some detail the factors that retailers consider in making that decision. We also noted that there is no uniform approach and that every retailer uses its own criteria. Slotting is used by *some* retailers to allocate some of the risk associated with these decisions. Other methods could be used to allocate this risk, like failure fees and sales on consignment basis. In the latter, which is used in other retailing sectors such as book stores, retailers do not take ownership of the product and are only paid if the product sells. Interestingly, many of those who complain about slotting are just as adamantly opposed to these alternatives.

The produce department is not exempt from the scarcity of shelf space or from the competitive marketplace. At the September 14, 2000 hearing the USDA testified that between 1987 and 1997, the average number of fresh produce items carried by retailers *doubled* from 173 to 345. Much of this increase comes from new bulk produce items from Asia and Latin America and from new packaged produce items. Over the same 10-year period the share of fresh cut and packaged salads increased from less than one percent to 19 percent. The total percentage of sales from branded produce has grown from 7 to 19 percent.

That is a tremendous explosion of variety competing for very scarce shelf space in a department where much of the shelving has to be refrigerated. Because of this it is even harder and more expensive to add shelf space in the produce department than it is in the dry grocery aisles. As USDA noted in its testimony, as a result of these changes, the buying and selling of produce has become more complex. There is a "greater reliance on long-term contractual relationships and strategic alliances." USDA is studying these changes in the marketing chain. Initially, it reports that slotting fees are more often associated with the sales of packaged and branded product. We look forward to the completion of USDA's study which is sure to present a more complete picture of the complexities of the marketing system than the grower witnesses at the September 14 hearing did.

11. Do slotting fees and other similar fees paid in relation to loose fruit and vegetables directly correlate to lower prices for such fruits and vegetables for the consumer?

12. Please explain whether slotting fees and pay-to-stay fees directly correlate to a lower price on the product for which such fee is paid.

The term "slotting fee" has been applied to a variety of practices. For purposes of this response, we use the term to refer to lump-sum, up-front payments that a supplier makes to a retailer for access to its shelves, including so-called pay-to-stay fees. As discussed below, even within the category of lump-sum, up-front payments there is significant variation.

FMI does not collect, maintain, or analyze data regarding its members' acceptance and use of slotting fees. Nevertheless, certain conclusions can be drawn about the potential impact of slotting fees on retail prices and consumer welfare.

The question that has been asked is whether slotting fees "directly correlate to lower prices . . . for consumers." In many cases, they do, but the existence of a direct pass-through is not the sole measure of consumer benefit.

Steven Salop, a widely respected professor of economics and law at Georgetown University Law Center, has observed that "[t]he competitive effects of trade spending may differ according to the form in which they are paid, the conditions under which they are paid and the details of the market structure of the upstream and downstream markets." Steven C. Salop, "Presentation to the FTC Slotting Fee Workshop," May 31, 2000 (text available on Federal Trade Commission's web site). Some slotting fees – including the type of lump-sum, up-front payments being discussed here – depend on the number of units the retailer purchases over a given period and are thus equivalent to a per-unit discount in the wholesale price. In competitive retail markets, slotting fees that reduce wholesale prices lead to lower retail prices. Salop, *supra*, at 2. The FTC agreed with this proposition in 1999 testimony before the House Committee on the Judiciary.[1]

Lower retail prices are not the only potential consumer benefit from slotting fees. Some slotting fees come with performance requirements, such as a requirement that the retailer engage in advertising, special product placement, or some other form of promotion or merchandising of the supplier's product. Such performance requirements benefit consumers by giving them more product information, selection, and convenience. See Salop, *supra*, at 2. Of course, they also benefit the supplier by enhancing sales of its product.

But even in the absence of a direct price pass-through or explicit performance requirements, there are potential benefits to consumers. Shelf space is a finite resource; for every item that is added, one is displaced. When display space is allocated to a new item, or where the space devoted to an existing item is expanded, slotting fees shift to the supplier some of the risk that this will be an unprofitable or less profitable use of the retailer's space. In addition, even if the slotting fee simply goes to the retailer's "bottom line," consumers may benefit. As Professor Salop has pointed out, "consumer benefits may occur in the longer run from the effect of the payments on spurring retailers' investments in new or larger stores. This increased investment can benefit consumers in the form of increased convenience and retail competition, which also can lead to lower retail prices." Salop, *supra*, at 3.

The FTC agrees that slotting fees may benefit competition and consumers even when they are not passed through directly in the form of lower retail prices. The Commission recently filed suit in federal district court in Washington, D. C. to block the merger of the Heinz and Beech-Nut baby food businesses. *FTC v. H. J. Heinz Co.*, No. CA 00-1688 JR (D.D.C.)(motion for preliminary injunction filed July 14, 2000). The centerpiece of the FTC's argument against the merger was that it would eliminate competition between Heinz and Beech-Nut in trade spending, including slotting fees paid for access to supermarket shelves. The Commission charged that the loss of this "distribution" competition would harm consumers.

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1 "Slotting Allowances and the Antitrust Laws," testimony of the Federal Trade Commission before the House Committee on the Judiciary, October 20, 1999, at 2-3.

The baby food category is dominated by a single national brand, Gerber. Virtually all supermarkets carry the Gerber brand and one other, typically either Heinz or Beech-Nut. According to the FTC, Heinz and Beech-Nut engage in winner-take-all competition to be the second brand on retailers' shelves: "With Gerber as the market leader found on almost all supermarket shelves, Beech-Nut and Heinz, effectively the only other firms in the market, compete head-to-head to be the second brand. This direct competition for shelf space has driven the market to a substantial degree, forcing Gerber as well to compete on price and innovation for sales to the consumer." Memorandum in Support of Plaintiff's Motion for a Preliminary Injunction, July 14, 2000, at 1. The Commission argued that this competition for shelf space -- competition in which the loser's product is excluded from the store's shelves -- benefits consumers. "Heinz and Beech-Nut compete aggressively to secure shelf space by offering supermarkets a variety of promotional allowances, discounts, couponing, and payments for shelf space. . . . American consumers stand to lose the benefits of this aggressive competition if Beech-Nut and Heinz are permitted to merge."[2]

Significantly, in the baby foods case the FTC argued that up-front slotting fees benefit consumers even if they do not directly lower retail prices (the FTC did, however, present evidence of pass-through). The FTC asserted that slotting fees have important non-price benefits, such as encouraging and supporting promotional and merchandising activities, and may benefit consumers even if they are simply used by the retailer to lower its costs. In closing argument, Judge James Robertson asked the FTC's counsel whether consumers benefit from slotting fees if the retailer simply says "you can have my shelf space, thank you, and I'll use the money for whatever I want to use it for." FTC counsel replied that the benefits of competition for shelf space are not limited to direct, quantifiable reductions in retail prices, and that the merger should be blocked even if there were no proof that slotting fees had been directly passed through to consumers: "[i]f the supermarkets somehow wind up with an additional dollar or two, that doesn't matter."[3]

As noted above, it is basic economics that wholesale price reductions will result in lower retail prices in competitive retail markets. Opponents of slotting fees have sometimes engaged in overheated rhetoric to the effect that a wave of supermarket mergers is making retail markets non-competitive. In fact, while there has been an upsurge in supermarket mergers, the FTC's merger enforcement program in this area has been extraordinarily active and tough. It is fair to say that in no industry have mergers faced more rigorous scrutiny. Numerous supermarket mergers have been abandoned or

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2 Id. at 11. All quotes are from the public version of the FTC's brief, which can be found on its web site.

3 FTC v. H. J. Heinz Company, No. CA 00-1688 JR, transcript of preliminary injunction hearing before the Honorable James Robertson, United States District Judge, September 21, 2000, at 15-20 (the relevant transcript pages are attached to this letter).

restructured to eliminate competitive "overlaps" that might reduce competition in local markets. Recent examples include the following:

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- Kroger's acquisition of Winn-Dixie's Texas Division. *Outcome*: Transaction abandoned after FTC filed suit to block the acquisition.
- Food Lion's acquisition of Hannaford. *Outcome*: Acquisition allowed to proceed only on condition that Food Lion divest 37 Hannaford stores to FTC-approved buyers in areas where the two companies competed.
- Ahold's acquisition of Pathmark. *Outcome*: Transaction abandoned after FTC staff rejected proposed divestitures and indicated intention to recommend suit.

1999

- Shaw's acquisition of Star Markets. *Outcome*: Acquisition allowed to proceed only on condition that Shaw's divest 10 supermarkets to FTC-approved buyers in areas where the two companies competed.
- Albertson's acquisition of American Stores. *Outcome*: Acquisition allowed to proceed only on condition that Albertson's divest 145 supermarkets in "overlap" markets to FTC-approved buyers.

In short, there is no support for the notion that supermarket merger enforcement has been lax and that this is resulting in a lessening of competition in grocery retailing. On the contrary, merger enforcement has been vigorous. Grocery retailing is more competitive than ever, as conventional supermarket operators compete for the consumer's food dollar not only with one each other but also with alternative grocery retailing formats, such as warehouse stores, and restaurants. One indication of the competitive dynamism of grocery retailing is that WalMart, which not long ago operated only mass-merchandise stores, is now tied with Kroger as the country's largest grocery retailer.

13. Do your member companies request and receive pay-to-stay fees on products that have already demonstrated significant consumer demand?

FMI does not collect or maintain information regarding the specific products as to which its members receive slotting fees; however, anecdotal evidence indicates that some manufacturers provide so-called pay-to-stay fees for products that are already established in the marketplace. Such payments are not anticompetitive. On the contrary, and as the FTC recently argued in challenging a merger between two established makers of baby foods (Heinz and Beech-Nut), consumers benefit when established products compete with one another for shelf space. Consumers would suffer if entrenched products or suppliers were exempted from such competition.

14. Do slotting fees always correlate directly to the actual costs of a retailer associated with new product introductions and with the lost opportunity costs of potential product failures?

See answer to questions 11 and 12.

15. In the hearing on September 14, 2000, the Committee received testimony from the produce industry that while historically declines in prices paid to growers would be passed along to consumers, today declines in wholesale prices do not generally correspond to declines in retail prices. Is this occurring and, if so, what is the rationale for not passing on to consumers decreases in the wholesale prices of fresh fruits and vegetables?

FMI does not track or record retail prices. As the question notes, however, historically declines in prices paid produce suppliers (and all other suppliers) are passed along to consumers. There is no reason to think that is not the case now. Food retailing is an extremely competitive business, net returns on sales are currently at the lowest levels in years and food price inflation remains extremely low. Our industry is proud of its ability to provide American consumers with a wide variety of quality products at prices that are the envy of the world.

16. Does FMI believe that slotting fees raise antitrust concerns? If so, under what circumstances can slotting fees be used in a manner inconsistent with antitrust laws?

As stated by John Motley in his September 1999 testimony before the Committee, FMI agrees with the Federal Trade Commission's frequently stated.view that slotting fees are legal in most circumstances.

In certain cases, slotting fees can raise antitrust issues. At the clearly unlawful end of the spectrum is commercial bribery, which occurs where a supplier secretly gives money or something else of value to an agent or employee to influence the purchase decision. Some opponents of slotting fees have drawn broad comparisons to commercial bribery, but the comparison is inappropriate. Commercial bribery involves personal gain to the recipient of the payment or other thing of value, and corruption of fiduciary duty.

As the FTC has pointed out, antitrust issues may arise if a dominant manufacturer, or a small group of manufacturers, uses slotting allowances to obtain commitments from a large number of retailers not to stock competitors' products or to restrict their shelf space.[4] Such an agreement might unreasonably foreclose competing manufacturers' access to the market. Determining whether there is an unreasonable foreclosure of

[4] "Slotting Allowances and the Antitrust Laws," Testimony of the Federal Trade Commission before the House Committee on the Judiciary, October 20, 1999, at 4-5.

competition is a fact-specific exercise. It requires, among other things, analysis of the level of concentration at the supplier and retailer level and the availability of alternative sales channels and outlets, assessment of the duration and durability of the exclusivity or partial exclusivity requirement, and evaluation of potential procompetitive effects.[5]

Finally, if a manufacturer provides slotting fees to one customer without making them available to competing customers, this may provide grounds for a claim under the Robinson-Patman Act. The Robinson-Patman Act prohibits certain discriminations in prices and promotional allowances by sellers of commodities. It also prohibits buyers from knowingly inducing or receiving unlawfully discriminatory prices. The FTC's *Guides for Advertising Allowances and Other Merchandising Payments and Services* state that "[t]he discriminatory purchase of display or shelf space, whether directly or by means of so-called allowances, may violate the Act, and may be considered an unfair method of competition in violation of Section 5 of the Federal Trade Commission Act." 16 C.F.R. § 240.9, example 5 n.1. The FTC recently brought a Robinson-Patman case against McCormick, the country's largest spice maker, based in part on practices resembling slotting fees.[6] Discriminatory provision of slotting fees has also been challenged in private suits under the Robinson-Patman Act.[7]

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[5] Id. at 6-7.

[6] McCormick & Company, FTC File No. 961-0050 (March 8, 2000, agreement containing consent order).

[7] Hygrade Milk & Cream Co. v. Tropicana Prods. Co., 1996-1 Trade Cas. (CCH) ¶71,438 (S.D.N.Y. 1996).

United Fresh Fruit
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Website: www.uffva.org

Memorandum

Date: **October 27, 2000**

To: **Senate Committee on Small Business**

From: **Tom Stenzel, President and CEO**
United Fresh Fruit & Vegetable Association

Subject: **Response to Questions from Senator John Kerry, Ranking Member Committee on Small Business Following Hearing of September 14, 2000**

1. *You classified slotting fees and other such fees as "off-invoice" fees. When a slotting fee is made, while it is kept off an invoice, do you know if the slotting fee is also "kept off the books?" In other words, is the slotting fee completely "under the table" or do the supermarkets pay the proper corporate income tax on them?*

We have no way of knowing how fees paid to a supermarket are handled in that company's accounting. We believe greater transparency in addressing whether such fees truly reduce the cost of goods sold to consumers, or are specifically used for their stated purpose such as promotional advertising, would be useful to all parties in understanding their impact.

Sometimes, fees are paid directly to corporate headquarters, and sometimes directly to a regional buying office. If specific fees are asked to be "under-the-table" and clearly meant to influence purchasing decisions, we believe both buyer and seller would be in conflict with the Perishable Agricultural Commodities Act. Similarly, if fees were asked to be paid personally to an individual, we would have the same concern.

Fees that generally do not appear on invoices are more often requested by buyers at some point in an ongoing relationship, as opposed to slotting fees for new products, or at the initiation of new business with a particular company. These fees are sometimes associated with capital costs of the buyer, such as store or warehouse renovations, or other special purposes the buyer believes justify a sharing of costs with the supplier.

2. *You explained that the retailer has less of an incentive to move volume because of slotting fees for produce, as the retailer's profit is in buying the produce rather than selling it. Given that, do you know of any situations in which retailers have stored or displayed produce in substandard or unhealthy conditions, which could generate a serious question of public health?*

We do not believe the storage or display of produce in substandard or unhealthy conditions should be related to slotting or similar fees. Retailers have tremendous business and legal incentives to maintain all foods they sell in sanitary condition. My comment has to do with whether a retailer has any incentive to sell fresh produce in greater volume, which government health authorities tell us is an important consumer health need, when profit margins are basically secured up front through slotting fees or cash payments. Our industry sees a disturbing trend of less produce advertising, less frequent low-cost specials for consumers, and declining in store promotions, even at a time when our members are spending greater sums in so-called "promotional" monies with retail customers. Our concern is that dollars paid for promotional fees are being used to ensure profit margins rather than truly promote the items that generate such fees.

3. *You brought up a fear that independent grocers may see slotting fees paid to big grocery chains as an opportunity to cash in themselves, particularly under the Robinson-Patman Act. Do you know of any situations in which independent grocers have attempted to do, or have done, just that? What additional strain on growers does that cause?*

During the Federal Trade Commission hearings on slotting fees earlier this summer, representatives of the independent grocery sector were quite direct in voicing this opinion. The National Grocers Association, an industry trade association, has expressed concern in its public statements and literature that independent grocers may have to take on suppliers and competitors alike in order to ensure that slotting and similar fees are fairly apportioned to smaller independent grocers. We are not aware of specific cases in which independent grocers or their representatives have taken direct action against grower suppliers. However, we take their public statements very seriously.

Responses by
Gregory T. Gundlach, Ph.D., Professor, Mendoza College of Business Administration, University of Notre Dame, Notre Dame, Indiana
To
Post-hearing questions posed by Senator John Kerry, Ranking member Committee on Small Business
Hearing entitled:
"Slotting Fees: Are Family Farmers Battling to Stay on the Farm and in the Grocery Store?"

1. **In point 6, you questioned whether retailers impose slotting fees or suppliers offer them. For clarification's sake, do you believe that suppliers would ever offer a slotting fee if they were not, or have never been, generally imposed by retailers?**

Response: Although historically characterized as a "fee" imposed by retailers on suppliers for acceptance of the supplier's new products, over time, the term "slotting" has become a generic label for a variety of trade-based fees and payments found across a product's distribution and retail life-cycle. In particular, some have stretched its meaning beyond its original definition and used the term to describe payments that are offered by suppliers to assist retailers in marketing the supplier's products. These include supplier payments for merchandising programs, special displays and other promotional efforts commonly defined as trade promotion. Where the term is defined and used in this fashion, suppliers may offer payments to retailers even though they were not, or had never been, imposed by the retailer.

2. **In point 10, you mentioned that some suppliers worry that they may face retribution from retailers for speaking out on slotting fees. Do you feel that the imposed secrecy of the practice contributes to a claim that imposing slotting fees are tantamount to extortion?**

Response: Though I hesitate to associate the apprehension of some suppliers to provide information or grant access to data on slotting for fear of retribution as tantamount to extortion, those attempting to obtain information on slotting face considerable challenge where this sentiment exists. Those suppliers that fear retribution often feel that such cooperation may be viewed as in opposition to slotting and that providing information or granting access to data about slotting fees will damage their retailer relationships.

3. **In point 22, you touched on the fact that slotting fees may have a negative effect on smaller retailers. Can you elaborate on how slotting fees do, in fact, hurt smaller, perhaps independent, retailers?**

Response: To the extent that slotting fees are associated with the bargaining power held by retailers over their upstream channel partners, one view is that compared to smaller retailers, larger and arguably more powerful retailers are better able to require payment of slotting fees and to receive higher amounts for the fees. If true, in the absence of proportionately higher offsetting costs, compared to their smaller counterparts, larger retailers can receive disproportionately greater profits from slotting fees.

Results of a recent survey provide some evidence of this prospect.[1] In a national survey of 379 manufacturers and 285 retailers, both groups of respondents agreed that "large retailers are more likely to require slotting fees than smaller retailers." Moreover, when asked the extent to which slotting fees have affected the "profit levels of larger retailers" and the "profit levels of smaller retailers," both manufacturers and retailers agreed that larger retailer's profits have increased more than the profits of smaller retailers. The survey did not inquire as to whether respondents felt larger retailers incurred proportionately higher offsetting costs than smaller retailers.

4. **In points 31 through 35, you discussed directions for future research. Would you say that until such time as growers are no longer afraid to speak out on slotting fees, until such time as they no longer fear retailer retribution, such research into slotting fees is unduly limited in its potential?**

Response: Yes. Researchers face considerable challenge in acquiring the type of data necessary to answer many of the pending questions applicable to slotting fees. Though to date some researchers have been able to obtain basic insights relying on secondary data and survey research methodologies that promise respondent anonymity and ask for industry-level perceptions, access to more specific, firm-level data is necessary to address the more critical questions. Data is needed, for example, that would allow researchers to determine and track the particular amount paid for a slotting fee, the obligations and conditions that accompany the payment and how the receipts from the payment are specifically used by the retailer. Until such time as those involved in slotting agree to cooperate to provide data of this kind, our potential understanding of this phenomenon is likely to remain limited.

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1 Paul N. Bloom, Gregory T. Gundlach, and Joseph P. Cannon (2000), "Slotting Allowances and Fees: Schools of Thought and the Views of Practicing Managers," Journal of Marketing, 64(2), 92-108.

COMMENTS FOR THE RECORD

Grower-Shipper Association
Of Central California

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September 28, 2000

The Honorable Christopher S. Bond
Chairman, Committee on Small Business
United States Senate
Washington, DC 20510

Dear Chairman Bond:

Re: September 14, 2000 Hearing on Slotting Fees
and Retail Trade Practices

Mr. Chairman and members of the Committee, thank you for allowing the Grower-Shipper Association of Central California to submit comments on this most important issue. The Grower-Shipper Association represents approximately 300 growers, shippers, packers, processors, and other firms connected to or affiliated with the production and marketing of vegetables and fruits in the California counties of Monterey, Santa Cruz, San Benito and Santa Clara. Gross values of crops grown in our Central Coast production area exceed three and one-half billion dollars. Our members take great pride in being on the "cutting edge" of production agriculture and several industry innovations (such as bagged salads) originated here. We commend the Chairman, the Committee, and Committee staff for investigating slotting fees and similar retail trade practices and their impact upon consumers and producers of fruits and vegetables.

The Grower-Shipper Association of Central California is deeply concerned by the ever-increasing use of slotting allowances within the retail grocery industry. They have become even more pervasive in the light of retail consolidation. As the Committee knows, slotting allowances are fees paid by manufacturers of consumer products to retailers for the privilege of placing and keeping their products on the retailers' shelves. While on their surface slotting allowances may seem like just another manifestation of the market, they are, in fact, profoundly anti-competitive. Our concern is that the unchecked proliferation of slotting allowances will reduce choice for consumers, lead to higher consumer prices, and, ultimately, harm farmers.

Slotting allowances come in many forms and for a wide variety of reasons – promotions, technology, advertising, store openings, distribution facilities, and interviews to name a few.

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Re: September 14, 2000 Hearing on Slotting Fees and Retail Trade Practices

Several of our members have informed me that they are being asked by some retailers to pay flat fees apart from invoice costs just to continue to do business. These fees are unrelated to any incentives or performance.

In general terms, slotting allowances have had two effects on growers and shippers. First, they cost money. The fees, payments, free product, advertising charges, warehouse contributions, etc. add up. In a business where margins can be extraordinarily thin these costs can make the difference between solvency and insolvency.

Second, the practice of slotting allowances in today's market is highly coercive. The terms 'shake-down' and 'protection money' are not far off the mark in describing some slotting allowance transactions. The Committee certainly has noticed the reluctance of individual produce growers or shippers to testify at today's hearing. Quite simply, they fear retaliation by the retail industry if they speak out publicly on this subject. They have experienced the strong arm tactics of an increasingly consolidated grocery industry in enforcing its slotting fee demands and have no faith that the retail monoliths won't strike back. The atmosphere of fear corrodes the market and undermines its ability to function in an arm's-length and transparent manner.

The Grower-Shipper Association is in the process of gathering detailed, factual accounts of these practices from our members – at all times taking necessary precautions to preserve their confidentiality and anonymity. We have offered our assistance to the U.S. Department of Agriculture Economic Research Service, the Federal Trade Commission, and the U.S. Department of Justice in their respective studies and investigations of these retail trade practices. We have worked closely with Committee staff on these issues as well, and will continue to do so in the future. We are hopeful that these efforts provide Congress with more substantial information as you proceed in your investigation.

I would like to thank the Chairman and the Committee for conducting this investigation and allowing me the opportunity to submit testimony.

Sincerely,

James W. Bogart

James W. Bogart
President and General Counsel

JWB:slo

United States Senate
COMMITTEE ON SMALL BUSINESS
WASHINGTON, DC 20510–6350

MEMORANDUM

From: David Bohley, Banking Counsel, Committee on Small Business
Paul Conlon, Research Analyst, Committee on Small Business

To: Karen Ponzurick, Legislative Clerk, Committee on Small Business

Subject: Recent Federal Court Ruling Relating to Slotting Allowances

Date: November 1, 2000

Since the September 14, 2000, hearing, the United States District Court for the District of Columbia issued its opinion on the Federal Trade Commission's (FTC) request for a preliminary injunction to temporarily halt the merger of the baby food divisions of H. J. Heinz Company and Milnot Holding Corporation (Beech-Nut). Given the relevance of this opinion to the issues addressed in the Committee's hearing and the FTC's inability to testify because of its involvement in this case, we request that Judge James Robertson's attached ruling be included in the hearing transcript.

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

FEDERAL TRADE COMMISSION,	:	
Plaintiff,	:	
v.	:	Civil Action No. 00-1688 (JR)
H. J. HEINZ, COMPANY, *et al.*,		
Defendants.		

OPINION

The Federal Trade Commission seeks a preliminary injunction pursuant to Section 13(b) of the Federal Trade Commission Act, 15 U.S.C. § 53(b), to enjoin the proposed merger of the baby food divisions of H.J. Heinz Company and Milnot Holding Corporation ("Beech-Nut"). The injunction is sought to preserve the status quo until full-scale administrative proceedings can determine whether the effect of the proposed merger "may be substantially to lessen competition" in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. The matter was the subject of a five-day evidentiary hearing and has been fully briefed and argued. This Opinion sets forth the factual findings and conclusions of law that form the basis for an order, issued today, denying the Commission's motion.

I. BACKGROUND

A. Market overview

Four million infants in the United States consume 80 million cases of jarred baby food annually, representing a domestic market of $865 million to $1 billion. See DX 617-0002; DX 38; DX 1-0012; PX 336 at 565; DX 435 at 52. There are only three major manufacturers and distributors of jarred baby food in the United States: Heinz, Beech-Nut, and Gerber Products Company. See PX 782 at 1-2. Gerber is by far the largest domestic manufacturer. It enjoys, and has enjoyed for some 40 years, a dominant market share that has recently grown to between 65 and 70 percent. See PX 781; DX 617, App. B. The Gerber market share is now 65 percent, the Heinz share 17.4 percent, and the Beech-Nut share 15.4 percent. See DX 617, App. B.

Heinz manufactures and distributes a variety of food products worldwide, and, despite its relatively low domestic market share, is the largest producer of baby food in the world. Heinz's domestic baby food products are manufactured at its Pittsburgh, Pennsylvania plant, which was recently updated at a cost of $120 million. The Pittsburgh plant now operates at 40 percent of its production capacity and produces 12 million cases of baby food annually.

Before its purchase by Milnot Holding Corporation from Ralcorp Holdings in September 1998, Beech-Nut had been owned by

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[1] Milnot is jointly owned by its management and Madison

seven different companies. See DX 435 at 23.[1] Beech-Nut's annual sales of baby food are $138.7 million, of which 72 percent is jarred baby food. Beech-Nut manufactures all of its baby food in Canajoharie, New York, see Milnot Admis. ¶13, at a manufacturing plant that was built in 1907 and began manufacturing baby food in 1931. See Tr. 858. The plant is not technologically current. Beech-Nut submitted proof that it would be prohibitively expensive to make further improvements in the Canajoharie plant, see DX 159; DX 641 at 25; that management has realized all the cost-savings that can be achieved in Beech-Nut's production and distribution, see DX 641-0023; and that, although Beech-Nut is currently profitable, its business is stagnant or declining without any realistic prospect of change. The FTC has not disputed this evidence.

Heinz and Beech-Nut both maintain that, despite all their efforts, neither is able to build market share, either against one another or against Gerber. See Tr. 440; 442-43; 859. Gerber, on the other hand, does not aggressively pursue market share, because, given its already dominant position in the market, striving for any further gain in market share "becomes so costly you get no return out of it." See DX 707-0001.

Dearborn Capital Partners, LP, a private venture capital firm based in Chicago, Illinois. See Compl. ¶4, Milnot Ans. ¶1. For clarity, Milnot is referred to by the trade name "Beech-Nut" throughout this opinion.

As the dominant firm in the market, Gerber is generally the first company to increase its price. Its prices have increased every year, above levels explainable by the rate of inflation.[2] Heinz has tended to follow Gerber's prices, but it markets its baby food as a "value brand," with a shelf price several cents below Gerber's. See PX 273 at 569; PX 415 at 153; DX 288-2109A, 0661A, 3380A. Gerber has expressed no desire to compete in the "value priced" sector of the market and has in fact conceded that market sector to Heinz. See DX 411; DX 412-0719. Beech-Nut strives to maintain price parity with Gerber, see Tr. 863, marketing its product as a premium brand, and has been able to maintain premium pricing without losing sales volume. See PX 3-4544. Gerber sometimes lowers prices against Beech-Nut, but only if and when Beech-Nut manifests sufficient strength in a particular market. See DX 411; DX 412-0719.

Gerber enjoys unparalleled brand recognition, and its brand loyalty is greater than that of any of product sold in the United States, including Coca-Cola and Nike. See DX 728-0001. Consumers generally view Heinz as being of slightly lower quality than Gerber. See PX 15; PX 429 at 341. Beech Nut's products are generally perceived as comparable in quality to Gerber's. See PX

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[2] Defendants' expert could not, however, rule out the possibility that Gerber's price increases are attributable to increased production costs. See Tr. 1026-27.

97-0861 to 0862.

Nearly all supermarkets stock only two brands of baby food, not three. See DX 617 at ¶23. Gerber is invariably one of the two.[3] The food products industry measures the extent of a particular product's presence in stores across the country by referring to a product's ACV (All Commodity Volume), which is stated as the percentage of stores that carry a certain product or product line. See Tr. 989, DX 1512. Gerber's ACV for jarred baby food approaches 100 percent, which means that Gerber is sold in virtually every food store in the United States. See DX 23-3630; Tr. at 989. Heinz has an ACV of approximately 40 percent, see DX 1-0069, and Beech-Nut, approximately 45 percent. See DX 444-2226. Heinz's sales are nationwide but are concentrated in northern New England, the Southeast and Deep South, and the Midwest. See Tr. 947, DX 15-0017. Beech-Nut's sales, also nationwide, are concentrated in the Atlantic region (New York and New Jersey), California, and Florida.

In general, witnesses described the baby food market as "boring," and "declining." See Tr. 441, 891-92; DX 38. During

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[3] Ninety percent of all purchasers of baby food say that they make their purchases at grocery stores or supermarkets. See PX 98 at 530. See id. Twenty-seven percent say that they purchase baby food at discount superstores such as Wal-Mart or K-Mart. Gerber's market share figure is even higher when mass merchandiser sales are included. The percentage of mass merchandiser sales compared to grocery store sales is growing. See Tr. 986-987.

the last five years, grocery store sales have fallen more than 15 percent, despite the fact that the birth rate has remained stable. See DX 2-0016; DX 1-0012; DX 14-0008. This decline is partially attributable to a shift from jarred baby food to table food. See 1-0012. Beech-Nut's sales have either been flat or declining since the early 1990s, and it expects this trend to continue. See DX 1098; DX 463.

B. Procedural history

On February 28, 2000, Heinz and Beech-Nut entered into a merger agreement. See DX 1314 at 16. Under the terms of the merger, Heinz would acquire 100 percent of Beech-Nut's voting securities for $185 million. On February 29, 2000, defendants filed a Premerger Notification and Report Form with the FTC and the Department of Justice, pursuant to the Hart-Scott-Rodino Antitrust Improvement Act of 1976, 15 U.S.C. § 18a. See DX 200-0001. On April 28, 2000, the FTC issued a Second Request for Information, which defendants complied with on June 8 and 9, 2000. See DX 460-0001; DX 299-0001. On July 7, 2000, the Commission (by a 3-2 vote) authorized this action for a preliminary injunction under Section 13(b) of the FTCA, 15 U.S.C. § 53(b). See FTC Press Release, FTC to Challenge Merger of Beech-Nut Nutrition Corp. and H.J. Heinz Co. (visited Oct. 5, 2000) <http://www.ftc.gov/opa/2000/07/heinz.htm>. The FTC filed its complaint and motion for preliminary injunction on July 14, 2000. I conducted a five-day evidentiary hearing in late August and early September, and I heard final arguments on September 21, 2000.

II. ANALYSIS

A. Legal standard

Section 7 of the Clayton Act, 15 U.S.C. § 18, prohibits a merger between two companies "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition . . . may be substantially to lessen competition, or to tend to create a monopoly." The Clayton Act authorizes the Commission to seek an injunction to prevent the consummation of any merger pending a full administrative hearing on its legality. See 15 U.S.C. § 53(b). The legality of a merger under Section 7 is a determination the Commission must make, and the Commission is not required in this preliminary injunction proceeding to demonstrate that the proposed merger would actually violate Section 7. See FTC v. Staples, Inc., 970 F. Supp. 1066, 1070 (D.D.C. 1997).

Instead, the Commission is entitled to injunctive relief "[u]pon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest." 15 U.S.C. § 53(b). "The Commission satisfies its burden to show likelihood of success if it 'raises questions going to the merits so serious, substantial, difficult, and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the Commission in the first instance and ultimately by the Court of Appeals.' " Staples, 970 F. Supp. at 1071 (quoting FTC

v. University Health, Inc., 938 F.2d 1206, 1218 (11th Cir. 1991)). The FTC must establish that there is a "reasonable probability" that the challenged transaction will substantially impair competition. Id. (citing cases).

The Commission can satisfy its initial burden of establishing a prima facie case for enjoining the merger by demonstrating that the merger will result in a firm that controls an undue percentage share of the relevant market and increases the concentration of firms in the market. See United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 363 (1963). Once the FTC has made that prima facie showing, the burden shifts to defendants to rebut the presumption of unlawfulness that arises. See United States v. Marine Bancorporation, Inc., 418 U.S. 602, 613 (1974); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 54 (D.D.C. 1998). The defendant's burden is one of production: a "clear" showing that the merger is unlikely to lessen competition is unnecessary. See Baker Hughes, 908 F.2d at 991-92. The ultimate burden of persuasion rests with the Commission throughout.

B. Relevant market

The first step in evaluating a merger is to define the relevant market. See Brown Shoe Co. v. United States, 370 U.S. 294, 324 (1962). The relevant product market is "determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it." Brown Shoe, 370 U.S. at 325. See also Staples, Inc., 970 F. Supp.

at 1074.

In this case, the parties agree that the relevant product market is jarred baby food. Jarred baby food can be replaced by homemade baby food and breast milk, but the Supreme Court's "interchangeability" test refers to products. See United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377, 395 (1956).

"A geographic market is the geographic area 'to which consumers can practically turn for alternative sources of the product and in which the antitrust defendant faces competition.'" Staples, 970 F. Supp. at 1073 (quoting Morgenstern v. Wilson, 29 F.3d 1291, 1296 (8th Cir. 1994)). Both sides resort to regional or Standard Metropolitan Statistical Area data for purposes of analyzing competition in the jarred baby food business. The Commission, presumably with an eye to the Clayton Act's reference to "commerce in any section of the country," has preserved its position that the proposed merger's effects may be evaluated at the regional or SMSA level. Its advocacy of that position, however, has been perfunctory. The proposed merger is national in character. It would join two companies, each of which has only one domestic production facility for jarred baby food products. The parties agree that the geographic market is no broader than the United States.

I find that the relevant market is jarred baby food in the United States.

C. Market concentration

It is undisputed that the baby food industry is a highly concentrated market, and the FTC adduced evidence that the proposed merger will significantly increase market concentration. Gerber's 65 percent market share results in a Herfindahl-Hirschman index of 4225.[4] The expert testimony establishes that the total index score for the baby food industry is 4775. See DX 617, App. B. The proposed merger would increase the index to 5285, an increase of 510 points. This increase is five times the 100 point threshold established in the Merger Guidelines. There is no serious dispute, and I find, that the proposed merger would increase concentration in an already highly concentrated market. That showing and my finding establish a prima facie case under Philadelphia Bank.

D. Barriers to market entry

"The existence and significance of barriers to entry are frequently . . . crucial considerations in a rebuttal analysis [because] [i]n the absence of significant barriers, a company cannot maintain supra-competitive pricing for any length of time." United States v. Baker Hughes, Inc., 908 F.2d 981, 987

[4] The Herfindahl-Hirschman Index ("HHI") is the sum of the squares of the market shares of all of the firms in a given market. It is an article of faith for the FTC, and it is recited in the FTC's Merger Guidelines, that any market with an HHI above 1800 is highly concentrated and that any merger in such a market that increases HHI by 100 or more points is presumptively anticompetitive.

(D.C. Cir. 1990). There have been no significant entries into the baby food market in decades. See PX 188, at 286. The Commission contends that new market entrants are unlikely. The parties are in agreement that the cost of entry is significant making entry difficult and improbable. See DX 617 at ¶26, 28, 30; PX 782 at 12. Ease of entry is not available to these defendants to rebut the Commission's prima facie case.

E. Nature and extent of competition between Heinz and Beech-Nut

The focus of the Commission's case is the competition between Heinz and Beech-Nut for the second position on the supermarket shelves, which its expert witness labeled "distribution competition." The other basic level of competition, labeled "consumer competition," id., was addressed at length by the defendants but not emphasized by the Commission.

1. "Consumer competition"

It is undisputed that Heinz and Beech-Nut are virtually never found in the same supermarket; that Beech-Nut and Heinz do not price against the other or even consistently monitor one another's prices; and that the cross-elasticity of demand between Heinz and Beech-Nut is not statistically significant. See DX 130. Heinz and Beech-Nut asserted, and proved with econometric evidence, that they do not constrain one another's retail or consumer prices. Heinz and Beech-Nut maintain that they do not price against the other, See Tr. 626-28, 863. The FTC adduced no evidence of direct price competition between Heinz and Beech-Nut in the same region or SMSA.

Defendant's expert, Dr. Jonathan Baker, was director of the FTC's Bureau of Economics from 1995 until 1998. Dr. Baker studied the markets where all three companies had a significant presence, see Tr. 953, and markets where only Heinz or Beech-Nut had a significant presence with Gerber, seeking to isolate the effects of competition on price. Relying upon IRI data,[5] Dr. Baker analyzed shelf prices to determine the effects of Heinz's and Beech-Nut's prices on Gerber, and vice-versa, and the effect of Heinz's prices on Beech-Nut's, and vice versa. His conclusion was that "consumer substitution between Heinz and Beech-Nut is very small and, therefore, the two firms are not constraining each other's pricing at the retail level very much." Tr. 955. He found no discernible differences in the price of baby food regardless of whether there were two or three competitors. "[B]ecause there is very little constraint on Heinz pricing from Beech-Nut," Dr. Baker stated, "this merger will not give Heinz any unilateral incentive to increase its price."[6] Tr.

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[5] IRI ("Information Resources, Inc.") provides data concerning cash register transactions that are commonly used in the food industry for market analysis.,

[6] The FTC challenged Dr. Baker's econometrics survey by arguing that it failed to consider the transaction price, i.e., the price after couponing, and relied instead on the shelf price. Dr. Baker convincingly responded by demonstrating that couponing occurs regardless of competition and that couponing does not greatly affect price over time.

969.

2. _"Distribution competition"_

By far the bulk of the evidence submitted by both parties concerned the nature and extent of distribution competition - the competition between Heinz and Beech-Nut to be the second brand on the shelf. Trade spending is the clearest indicator of distribution competition. Trade spending is characterized as either "fixed" or "variable" and involves the payment of negotiated sums of money to retailers or retail chains. Fixed payments consist of "slotting fees," "pay-to-stay" arrangements, new store allowances, etc., _see, e.g._, Tr. 901, 1133-35; PX 482 at 34-36, but are all essentially given in exchange for shelf space and desired product display. Variable payments, unlike fixed payments, are ostensibly tied to sales volume, _see_ Tr. 970-71, and consist of "long term allowances" and merchandising funds. Long term allowances are payments to retailers, typically made upfront, that are intended to assure a specific sales volume and lower shelf price. _See_ DX 85 at 47, Tr. 613. In theory, these allowances are refundable on a _pro rata_ basis in the event that the retailer does not meet the desired volume. Merchandising funds, _see_ Tr. 619, are offered to support temporary price reductions and sales, and include price discounts, retailer "loyalty card" discounts, or coupons. _See_ Tr. 574.

The Commission attempted to show that trade spending competition between Heinz and Beech-Nut benefits consumers and that the merger will eliminate that benefit. With respect to fixed trade spending, the attempt failed completely. Fixed trade spending, according to testimony by Heinz's expert, which was corroborated by retailers' testimony, has no effect on the shelf price. See Tr. 160-62, 594, 864-65; PX 75; DX 81.

Variable trade spending does benefit consumers in theory, see Tr. 973-94, but the record provides no basis for quantifying that benefit. Moreover, the record leaves substantial doubt that the proposed merger would actually affect variable spending levels. All three companies use discounts, coupons and loyalty card programs to create price differentials. The merger will not change the need for such spending. Long-term allowances are paid in the bid competitions that have taken place between Heinz and Beech-Nut, but there is no evidence that any retailer has ever refunded money after failing to meet a sales target.

Dr. Baker's econometric analysis revealed that trade spending levels had no effect on price, even in markets where all three firms are present. See Tr. 588, 590, 591, 594-95, 863, 865, 867; DX 617-0015. Variable trade spending has fallen, and fixed trade spending has risen, in response to retailer consolidation, which has allowed retailers greater bargaining power in negotiating contracts with manufacturers. See DX 617-0024. Increases in trade spending during bid competition for these contracts consisted almost entirely of increases in fixed spending. See DX 617-0023.

The evidence to support the FTC's assertion that the proposed merger will affect variable trade spending levels and consumer prices is thus, at best, inconclusive. The FTC did submit examples of short-term couponing initiatives that resulted in lower prices, but absent a stronger connection between these couponing initiatives and competition between Heinz and Beech-Nut for shelf space, it is impossible to conclude with any certainty that the consumer benefit from such couponing initiatives would be lost in the merger.

3. Innovation and product differentiation

The FTC did not assert or prove that there has been any significant competition between Heinz and Beech-Nut in terms of innovation or product differentiation. Indeed, the evidence is that, as the market is now configured, neither Heinz nor Beech-Nut is strong enough to compete successfully in these areas.

When Heinz attempted to market a premium all-organic product known as "Earth's Best," Gerber immediately launched its "Tender Harvest" line and offered special incentives to retailers if they agreed to discontinue the Heinz product. See DX 14-0049. The launch of Earth's Best failed, and Heinz sold the product line at a $10 million loss. See Tr. 449. When Beech-Nut ran advertisements illustrating differences between its products and Gerber's in terms of their nutritional value, Gerber retaliated by lowering prices and increasing consumer promotion spending in Beech-Nut areas, driving Beech-Nut's volume down dramatically.

See DX 411-0199. Beech-Nut officials testified that this experience taught them to adopt a less competitive posture to avoid losing market share again.

F. _Likely post-merger competition_

The central contention of the defendants is that the merger is the only way to challenge Gerber's dominant market share. Defendants argue that their merged baby food business will be much more efficient, and that the efficiencies will be used to compete with Gerber. They argue that, with the best of the two brands' recipes, Heinz's value pricing strategy, and Beech-Nut's brand equity, they will have a more attractive and attractively priced product. And, they argue, their combined shelf space will give the merged business - at last - an ACV high enough to enable serious efforts to innovate.

This is a variant on the "against giants" defense first suggested by the Supreme Court in _Brown Shoe_: "[w]hen concern as to the Act's breadth was expressed, supporters of the amendments indicated that it would not impede, for example, a merger between two small companies to enable the combination to compete more effectively with larger competitors dominating the relevant market." 370 U.S. at 319. _See generally_ Julian O. von Kalinowski et al., _Antitrust Law and Trade Regulation_, § 30.04[5] (2d ed. 1999).

Following structural antitrust doctrine, however, the Commission predicts that a merged Heinz/Beech-Nut will not actually engage Gerber in very much competition; that, sooner or later, the merged entity will lapse into following Gerber's price increases and taking profits; and that, in the absence of a third competitor, the merged entity will find it easier to engage in coordinated interaction and collusive activity, see Tr. 197-198. The same antitrust doctrine, as well as case law, counsels that I discount or disregard the aspirational testimony of Heinz's chief executive officer, who stated that this merger was not intended to eliminate a competitor but is part of a larger plan to challenge Gerber at the national level, see Tr. 452-53, 463; invoking his proven record of stirring up stagnant companies and building market share, see Tr. 458, 463-64, 509; and referring to the demands of Wall Street that companies not rest on their laurels but demonstrate continuing growth, see Tr. 453.

My conclusion in this case does not rest upon aspirational testimony, but instead credits powerful evidence in the record about the efficiencies realized by the merger, and about the enhanced prospects of the merged entity to introduce innovative products to compete with Gerber. That evidence, in my view, shows that the Commission's prima facie case inaccurately predicts the merger's probable effect as future competition. See Baker Hughes, 908 F.2d at 990.[7]

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[7] The Commission's argument that further concentration in the baby food industry will increase the likelihood of collusion was effectively rebutted by Dr. Baker's testimony regarding the structural market barriers to collusion in the market. See Tr. 1010-1023.

1. Efficiencies

Noting that "some lower courts . . . have begun to consider efficiencies claims in mergers," FTC Staff Report, Anticipating the 21st Century: Competition Policy in the New High-Tech, Global Marketplace, Ch. 2 at 27 (May 1996), the Commission amended its Merger Guidelines in 1997 to provide that "efficiencies are properly considered in merger analysis," id. at 1; see also Baker Hughes, 908 F.2d at 985, if they are merger-specific and cognizable - i.e., verified and not the result of anticompetitive reductions in output and services.

Heinz calculates that it will achieve merger-specific savings of between $9.4 million and $12 million. See Tr. 759. Production of baby food products will be consolidated at the more advanced Pittsburgh plant, which can handle the combined volume of Heinz and Beech-Nut sales and still have 20 percent capacity available for future growth. See Tr. 684. Consolidation of production in the automated Pittsburgh plant will achieve substantial cost savings in salaries and operating costs. (At the Canajoharie plant it takes 320 workers to produce 10 million cases of baby food, while 150 workers produce 12 million cases at Pittsburgh.) Substantial savings would also be realized in the cost of converting raw materials, reducing waste, and consolidating administrative overhead. Defendants adduced the testimony of David Painter, who evaluated mergers at the Commission for many years. He found the variable manufacturing cost savings that will be achieved in the merger "substantial, significant . . . among the largest that I have ever seen certainly in a manufacturing segment." Tr. 750; DX 629 at ¶ 82. Consolidation of production in the Pittsburgh plant, he found, would reduce the cost of processing the volume of baby food now produced by Beech-Nut by some 43 percent, a savings he found "extraordinary." Tr. 759-760.

Heinz also argues that its distribution network is much more efficient than Beech-Nut's current system. By taking advantage of Heinz's six regional distribution centers, Heinz argues that it can cut substantial costs that result from Beech-Nut's current distribution network, which includes only two distribution sites.

These are the kinds of efficiencies recognized by the Commission's Horizontal Merger Guidelines ¶ 4: "efficiencies resulting from shifting production among facilities formerly owned separately, which enable the merging firms to reduce the marginal cost of production. . . ." They will "enabl[e] the combined firm to achieve lower costs in producing a given quantity and quality than either firm could have achieved without the proposed transaction." Id. In the context of this particular case, those efficiencies will enable Heinz to provide the best of the two companies' recipes under the new Heinz/Beech-Nut (or Beech-Nut/Heinz) label, and to apply its value pricing strategy to the entire combined production volume. The Commission does not seriously dispute the proposition that the merger will result in better recipes for former Heinz buyers and value pricing for former Beech-Nut buyers. Those consumer benefits will be immediate and virtually automatic, and to recognize them does not require accepting at face value the aspirational testimony of Heinz executives. Whether Heinz will use the considerable cost savings from the merger to mount a vigorous campaign against Gerber for shelf space and market share remains to be seen. When the efficiencies of the merger are combined with the new platform for product innovation, however, it appears more likely than not that Gerber's own predictions of more intense competition, see DX 701 at 199; DX 717 at 147; DX 703 at 183, will come true.

2. Innovation

The conditions for increased competition in the form of product innovation and product differentiation will be enhanced by the merger, because the distribution of the combined entities will add Heinz's ACV to Beech-Nut's ACV. Current Heinz policy disfavors attempts to launch new products in the absence of substantial nationwide distribution, see Tr. 442, 446.[8] The testimony of defendants' expert Professor Baker explains and justifies that policy. He testified that new product launches

[8] The failure of Heinz's attempt to launch its Earth's Best brand, supra, may or may not have been foreordained by Heinz's low ACV. The testimony of Heinz witnesses was that Gerber responded immediately to Earth's Best with its own new label, and that Gerber, with its ACV of nearly 100, was able to overwhelm Heinz's launch effort. See Tr. 446.

are only practical when a firm's ACV is high enough - his threshold is 70 percent - to ensure higher levels of distribution, so that marketing is cost effective, see Tr. 990.

The merged entity will have an ACV of about 90 percent (some 10 percent of food stores carry only Gerber). That ACV will be high enough to support introduction of the Heinz Environmental "Oasis" program that is already in place in Europe, as well as a planned aseptic baby food product. As Heinz describes its Oasis program, it is an effort to convince mothers that Heinz baby food is "more nutritious and safe than anything that they can do themselves." PX 695.

The FTC asserts that Heinz has over-estimated the probable success of the Oasis program, challenges Professor Baker's use of an ACV threshold of 70 percent as too high, and argues that there are no barriers to Heinz's innovation because it has the ability to spread development costs for new products over its broader world markets, thereby making development more cost effective. Those assertions, however, are mainly lawyers' arguments. Their record support in Dr. Hilke's conclusory testimony I found unconvincing.

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> [T]he economic concept of competition, rather than any desire to preserve rivals as such, is the lodestar that shall guide the contemporary application of the antitrust laws . . . . [T]his principle requires the district court . . . to make a judgment whether the challenged acquisition is likely to hurt consumers, as by making it easier for

> the firms in the market to collude, expressly or tacitly, and thereby force price above or farther above the competitive level.

Hospital Corp. of Am. v. FTC, 807 F.2d 1381, 1386 (7th Cir. 1986) (Posner, J.). The Commission made its prima facie case by showing increased market concentration. The defendants rebutted that case with proof that the proposed merger will in fact increase competition. The Commission responded to the rebuttal case essentially with only structural theory.

"Section 7 involves probabilities, not certainties or possibilities. The Supreme Court has adopted a totality of the circumstances approach to the statute, weighing a variety of factors to determine the effects of a particular transaction on competition." Baker Hughes, 908 F.2d at 984. I find it more probable than not that consummation of the Heinz/Beech-Nut merger will actually increase competition in jarred baby food in the United States.

G. Equities

Weighing the equities in a merger case requires considering "the potential benefits, public and private, that may be lost by merger blocking injunction, whether or not those benefits could be asserted defensively in a proceeding for permanent relief." FTC v. Weyerhauser Co., 665 F.2d 1072, 1084 (D.C. Cir. 1981). The public equities involved in this case are

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[9] The parties have not stressed private equities, but I

quite straightforward.[9] On the one hand, if the merger is allowed to proceed before the full-scale administrative proceedings contemplated by the Federal Trade Commission Act can be had, the outcome of such proceedings will not matter, because the Canajoharie plant will be closed, the Beech-Nut distribution channels will be closed, the new label and recipes will be in place, and it will be impossible as a practical matter to undo the transaction. On the other hand, if the Commission's motion for preliminary injunction is granted, the defendants' right of appeal under 28 U.S.C. § 1292(a)(1) will not matter: "[I]t is well recognized that the issuance of a preliminary injunction prior to a full trial on the merits is an extraordinary and drastic remedy. This is particularly true in the acquisition and

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have nevertheless considered them. The private equities here - the corporate interests of Heinz and Milnot and especially the interests of Dearborn Capital Partners LP, which presumably acquired Milnot through a leveraged buyout with the purpose and intent of selling its interest at a profit - are undoubtedly important to the private parties, but they do not affect the outcome of this matter.

Beech-Nut asks me to recognize, perhaps as an equity matter, a variant of the "failing firm defense." See Dr Pepper/Seven-Up Cos. v. FTC, 991 F.2d 859, 864-65 (D.C. Cir. 1993). The argument is that the static state of the baby food market will make Beech-Nut's outmoded means of production less and less profitable, eventually rendering Beech-Nut uncompetitive and reducing the market to two firms. I have given no weight to this argument. Beech-Nut may have indeed realized its maximum profit potential, and it may be unable to boost production or distribution. At present, however, it is a profitable and ongoing enterprise.

merger context, because, as a result of the short life-span of most tender offers, the issuance of a preliminary injunction blocking an acquisition or merger will in all likelihood prevent the transaction from ever being consummated." FTC v. Exxon Corp., 636 F.2d 1336, 1343 (D.C. Cir. 1980).

It is undisputed that a preliminary injunction would kill this merger. Appellate review of my decision in this case is thus, as a practical matter, available only if the motion for preliminary injunction is denied. While this observation does not affect the overall resolution of the instant motion, it is a factor that tips the balance of the equities slightly in favor of denying the motion.

III. CONCLUSION

Although the Commission did establish a prima facie case supporting a preliminary injunction, it did not effectively respond to the defendants' rebuttal evidence, and it ultimately failed to sustain its burden of persuasion for the proposition that it is likely to succeed on the merits. Having considered the Commission's likelihood of ultimate success, and having weighed the equities, I conclude that it would not be in the public interest to grant the Commission's motion for preliminary injunction. An appropriate order accompanies this Opinion.

JAMES ROBERTSON
United States District Judge

Dated: ______________________

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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

FEDERAL TRADE COMMISSION,	:	
	:	
Plaintiff,	:	
	:	
v.	:	Civil Action No. 00-1688 (JR)
H. J. HEINZ, COMPANY, *et al.*,		
Defendants.		

ORDER

For the reasons stated in an opinion issued today, it is this ______ day of October, 2000,

ORDERED that the motion of the Federal Trade Commission for preliminary injunction [#2] is denied.

JAMES ROBERTSON
United States District Judge

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OFFICIAL TRANSCRIPT PROCEEDING

FEDERAL TRADE COMMISSION

MATTER NO.	**P001201**
TITLE	**SLOTTING ALLOWANCES WORKSHOP**
PLACE	**FEDERAL TRADE COMMISSION** **6TH & PENNSYLVANIA AVENUE, NW** **ROOM 432** **WASHINGTON, DC 20580**
DATE	**MAY 31, 2000**
PAGES	**1 THROUGH 148**

SLOTTING ALLOWANCES WORKSHOP

VOLUME 1

FOR THE RECORD, INC.
603 POST OFFICE ROAD, SUITE 309
WALDORF, MARYLAND 20602
(301)870-8025

FEDERAL TRADE COMMISSION

I N D E X

FEDERAL TRADE COMMISSION

In the Matter of:)
WORKSHOP ON SLOTTING ALLOWANCES.)
----------------------------------)

MAY 31, 2000

Room 432
Federal Trade Commission
6th Street and Pennsylvania
Ave., NW
Washington, D.C. 20580

The above-entitled matter came on for panel discussion pursuant to notice, at 2:00 p.m.

CHAIRMAN PITOFSKY: Good afternoon, everyone. I'm Bob Pitofsky, chairman of the Agency, and it's a great pleasure for me to welcome you to this workshop on slotting allowances and other grocery marketing practices.

This is an important subject. Indeed, we've come around to the view that it's increasingly of importance to competition and consumer welfare in the grocery sector of the economy.

We come to this hearing, as we do in other situations, with no fixed preconceptions. I'm convinced that there are circumstances in which slotting allowances make great business sense and contribute to consumer welfare. I'm sure there are others in which they are competitive problems, and probably in many situations they're competitively neutral.

What we're looking forward to here is a day and a half of opportunity to hear from a wide array of people -- large and small businesses, consumer representatives, practitioners and academics -- about which is which, where slotting allowances are efficient and effective, and where they raise problems.

In doing so, I'm especially pleased that this is an opportunity to renew an FTC role that I believe its founders had in mind when this agency was created in

1914. The founders were Louis Brandeis, later Mr. Justice Brandeis, and President Woodrow Wilson. The idea was not simply to have another law enforcement agency, but rather an agency that would anticipate problems in the commercial sector, work with business, work with consumers, get the facts, anticipate these issues, report to the public and report to Congress.

And some of the great successes in the agency in its early years were exactly that sort of project, like hearings on stock market manipulation, which led to the establishment of the Securities and Exchange Commission. We've tried to restore that tradition over the last five years with hearings on antitrust and innovation, global competition and privacy on the Internet. I regard this as in that tradition of investigation, hearings, workshops, proposals.

I don't think we're going to end up with a federal slotting-allowance commission. I certainly hope not, but it could sensitize this agency to the issues that are involved.

We will hear today and tomorrow from 40 people representing assorted views in this area, and the staff has been at work on this for several months. We've interviewed some 80 people, and those interviews will be part of the record. The interest is very high.

Actually there was a time when the staff was a little concerned about holding this workshop. There wouldn't be enough people who would testify. There weren't enough people who would be interested. I think the people here today, the number of people here today, and in an overflow room elsewhere in the building, shows that we didn't have anything to worry about.

Let me also acknowledge and thank the work of Susan DeSanti, the head of our policy planning unit, and David Balto, and their staffs for the tremendous work that they've done in putting this session together.

Our first speaker today will be Senator Christopher Bond, Chairman of the Senate Committee on Small Business. He has long demonstrated an acute interest and a special sensitivity to these issues, and he wanted to contribute his thoughts at the start of our workshop. His schedule didn't permit him to be here, but he has submitted a statement by means of a videotape.

Are we ready to run that? We are ready. We're not ready?

MR. BALTO: Yes, we're ready.

(Whereupon, the videotaped statement of Senator Christopher Bond was shown.)

SENATOR BOND: Thank you for joining us for today's workshop hosted by the Federal Trade Commission.

As Chairman of the Senate Committee on Small Business, I applaud the FTC for convening this workshop to explore the antitrust implications of slotting allowances and other potentially anticompetitive retail trade practices. The FTC's decision to hold this workshop is a timely response to the growing concerns about slotting allowances among consumers and the small business community.

For small businesses, this is a very serious subject that touches the livelihoods of owners and employees alike.

At our hearing last fall before the Senate Small Business Committee, small grocery manufacturers testified with hoods and voice scramblers to conceal their identities, because they feared retribution from dominant manufacturers and retail chains. Following the hearing, the Committee's investigators looked at other industries and found evidence of slotting and other questionable trade practices in the sale of books, computer software, compact disks, consumer electronics and even fresh produce.

We interviewed over 200 small manufacturing representatives who spoke of marketplace abuses of dubious legality, which are destroying small manufacturers and limiting consumer choice.

The Senate Committee on Small Business will continue its bipartisan efforts to assist the FTC in every way possible to combat slotting abuses. We look forward to receiving recommendations and guidance from the FTC on these matters.

This workshop presents manufacturers, retailers, academics, attorneys, and public policy professionals with an open forum and a unique opportunity to work directly with the antitrust regulators at the FTC.

This is truly a complex problem and I hope today's workshop will shed new light on slotting abuses and other practices prohibited by the Sherman Act, Robinson-Patman Act, and Clayton Act. I assure you that my ranking member, Senator John Kerry, a Democrat from Massachusetts, and I, as well as the other Committee members, will be watching very closely to see the recommendations which come from this session as well as from the FTC investigations.

We thank you for your efforts and we look forward to working with you to ensure that small businesses who manufacture products for retail shelves have the opportunity to present those products and consumers have the choices that these small businesses can provide. Thank you.

(Whereupon, the videotaped statement of Senator Christopher Bond was concluded.)

MS. DESANTI: Good afternoon. I also would like to welcome you. I'm Susan DeSanti. I'm Director of Policy Planning at the Federal Trade Commission, and it's my good fortune to be here this afternoon to learn from what we hope will be an excellent workshop.

I want to be very clear in giving the credit for putting this together to David Balto, who has worked in a terrific manner with his team. David is Assistant Director for Policy and Evaluation in the Bureau of Competition, and together with his team of Neil Averitt, an attorney in his shop, Chris Garmon, of the Bureau of Economics, and my Deputy Director for Policy Planning, Bill Cohen. They've done a perfect job in putting all this together.

To begin the afternoon, we're going to have two presentations to help set out some of the basics about slotting allowances -- what they are and how they fit into retail promotion practices generally.

The first will be by Professor Greg Gundlach, an associate professor of marketing in the Business School at Notre Dame. Professor Gundlach has taught marketing for more than a decade, and we have found that he has done some of the most comprehensive and thoughtful work on slotting allowances so we asked him to make this presentation about his research.

The second presentation will be by David Balto and Neil Averitt who I've just mentioned. David and Neil, together with economist Chris Garmon, have been taking a closer look at slotting allowances for the past several months, talking to literally dozens of manufacturers, retailers, consultants, and even other lawyers and economists.

David and Neil will briefly discuss some aspects of the competitive analysis of slotting allowances and also will provide a road map of the questions that will be discussed at the panels that we will be having today and tomorrow.

Professor Gundlach?

MR. GUNDLACH: Thank you, Susan. I'm very pleased to be here today to join you to talk about a very complicated phenomena called slotting allowances and fees. My role today is to provide a foundation for discussion over the next two days' deliberations, and the way that I'll be doing that is to report, as Susan mentioned, on a study that was conducted by myself, Bob Bloom, Joe Cannon -- colleagues that investigated management views of slotting-allowance practices.

An article that draws together most of the research that I'm presenting today appears in this month's issue of The Journal of Marketing.

Let me provide you with just a basic overview of my discussion today. The objectives of the study were to obtain the management views -- that of manufacturers and retailers -- as it relates to these practices. We are very much interested in the types of practices found, in terms of the nature of fees, their usage characteristics, just how these fees were used in practice, what types of fees, administrative practices, and what kind of trends were involved.

In addition to that, we were also interested in factors that managers felt contributed to the occurrence of slotting fees over time, and most interested in the role and effect of these fees as they relate to various outcomes. What we found in this regard were two schools of thought based on the literature, and I'll talk about those more specifically in time.

Our approach was to focus on the grocery industry, which, through industry interviews, we found to have the highest prevalence of slotting practices. We incorporated a large-scale national survey that gathered the opinions of both manufacturers and retailers. Almost 1,200 manufacturers were surveyed, in addition almost 1,200 retailers.

The one caveat that I have to note in this study is that we gathered the opinions of managers. While in one respect this is an excellent approach in that it allows us to talk to those specific individuals who are involved in the practices, it also should be mentioned that these are the opinions of managers, and the appropriate caveats must be accompany that type of interpretation of many of the results.

For the study, we focused on fees that we thought were most common in practice. These fees are identified here and also on the poster board exhibits. As you can see, they cover what we might refer to as the life cycle of a product at retail. We were interested in the five types of fees: Presentation fees, or fees made for the privilege of making a sales presentation; more common slotting fees, in terms of the rubric or up-front payments of cash, promotional dollars, or merchandise to obtain shelf space for a product; display fees, or fees paid for special merchandising and display of products; what are referred to as pay-to-stay fees, or fees paid to continue stocking and displaying a product; as well as failure fees, or fees paid when a product does not meet expected goals.

I should mention there are several other types of fees when you speak to manufacturers and retailers, and different names are often attached to the fees that I've listed here.

In terms of what we found in speaking to manufacturers and retailers, I report here mainly the results where both manufacturers and retailers tended to agree on the subject matter. The most frequent types of fees included slotting fees or up-front payments of cash, promotional dollars or merchandise to obtain shelf space of a product, and display fees, which are fees paid for special merchandising and display of products.

The other fees that I mentioned were found to be less common in use but still used. In terms of trends, when asked to report back in terms of the past five years, retailers and manufacturers told us that retailers were more likely to require slotting fees of all kinds.

We are also interested in the administrative practices associated with the use of slotting fees. Given the private nature of these fees and their often off-invoice nature and character, we were interested in whether or not the policies and practices and procedures associated with these fees were changing.

What we found were that written contracts were not that commonplace, and while negotiations -- in terms of negotiations, some manufacturers were able to negotiate -- there was only a limited increase in negotiation over time. We also found that not all manufacturers were viewed as paying the same for the similar type of SKU.

An area of particular interest for us was the types of product categories where slotting practices were most often found. We asked individuals to report back three categories in which they identified slotting practices to be heavily used and three categories where they found slotting practices to be lightly used.

A variety of different opinions exist as to why we would find slotting fees in various different categories. For example, some suggest that slotting fees should be found in lower-margin categories as a basis to bolster retailer profits in those categories. Another opinion is that higher-margin products are where slotting practices are found, and the basis for this opinion is that the slotting fees themselves compensate for the lost revenues and opportunity costs if the product fails. Still other opinions suggest that slotting fees will be found where shelf space is at a premium, such as what might be found for frozen foods and other dairy products.

Our findings were really somewhat confused as to any one of those hypotheses. However, we did find that product categories of heavy use included frozen food, dry grocery and beverages; and those of light use included fresh meats and seafood, produce, and deli.

An important inquiry for us was whether or not these fees had extended into products that were no longer considered new products, that is established products. Many of the explanations that I'll focus on later require as an assumption that we're dealing with new products. The results here were mixed. Manufacturers felt the practices had extended into more established products. Retailers were somewhat neutral in terms of their views.

Another area of interest for us was identifying the factors that were contributing to the occurrence of these fees. What did manufacturers and retailers believe were the basis for these fees to occur in the first place? While I have a variety of different factors listed, I'll push quickly through those in terms of their groupings and provide you some basis for our result.

As many of you know, new products and those types of common proliferation issues -- novelty, failure, and technologies associated with new products -- are commonly identified. Cost and profit factors are also mentioned. Channel structure issues are also captured in many arguments, and, in addition, promotion and branding factors.

Let me highlight some of these that might not be self-explainable. In terms of the retailer influence under channel structure, while some studies disagree, some contend that the increasing consolidation and other factors have increased the market clout on the part of retailers leading to the occurrence of these fees.

On the promotion and branding area, the use of push strategies on the part of manufacturers to get their products to the marketplace is also highlighted. The distinction here is that all strategies are strategies of promotion focused directly towards the consumer to create demand on the part of the consumer and thereby pull the product, in this case a new product, into the marketplace.

As a result of the increasing costs of these types of promotion practices and what has been referred to as their lessening effectiveness over time due to diminished consumer loyalty, a lack of differentiation of new products, as well as the emphasis on short-term profits, have caused some manufacturers to shift from "pull" forms of promotion to "push" strategies in which incentives are provided directly to the trade in order to promote a new product.

Finally then, in terms of promotion and branding, I should point out that the increasing growth of private-label store brands has been identified as a factor. Increasingly these products are accounting for a growing percentage of products in any category. These products have higher margins and often don't have slotting fees associated with them.

Often slotting fees are viewed as a basis for compensating retailers for the lost opportunity of products in these types of areas. Our results on both sides of the score card, manufacturers and retailers, we found some agreement, typically in the area of new products. Both manufacturers and retailers agreed that the growth in the number of new products, and the high failure rate of new products, both contributed to slotting fees. Both manufacturers and retailers agreed that the increasing use of "push" strategies by manufacturers were also a contributing factor.

Where manufacturers and retailers disagreed, however, was in the area of retail influence as a factor, and, on the retailer's side, the increasing cost of handling new products.

An area of particular focus for the study was examining the variety of explanations that have been provided in the literature to explain slotting fees and their effects. Just exactly what are the role and effects of slotting fees and similar practices?

In examining the literature, we found two schools of thought with associated explanations underlying each. On the one hand, the efficiency school saw slotting fees as a mechanism for improving distribution efficiency and enhancing competition. On the other hand, the market power school viewed slotting fees as a tool for enhancing market power and undermining competition.

Let me focus on the explanations that underlie those two schools of thought. Underlying the efficiency school there are a variety of explanations that focus on different aspects of the relationship between manufacturers and retailers, as it relates to new products and how they're handled in the marketplace.

One explanation is the signaling and screening argument. The contention here is that slotting fees enable manufacturers to communicate and retailers to evaluate information regarding new products. The key here is that slotting fees are used as a mechanism to distinguish successful products from those that are not, both on the part of manufacturers signaling what they believe to be the most successful products through paying slotting fees, and retailers screening the payments of these fees for products to discern which products they believe will be successful in the marketplace.

A second argument under the efficiency school is risk shifting. Slotting fees here are said to help reallocate the risks of new product introductions to those best able to control them. The view here is that manufacturers, as a source of product innovation, are more informed about the potential success of a new product and therefore should also address the risk in terms of those new products. Here slotting fees are viewed as simply a mechanism for shifting that risk back to those who are believed to be best informed -- that is, to the manufacturers.

Another argument is cost sharing. Here slotting fees are deemed to compensate retailers for the increasing costs of introducing and managing a proliferation of new products. The contention here is that many new products are introduced without sufficient support or testing. Manufacturers as a source of innovation are suggested in this respect to be also responsible for sharing those costs associated with the introduction of that product.

Another contention is that slotting fees serve as a basis for enabling retail shelf space to be allocated to its best and highest use. The idea here is that shelf space is a commodity, and a slotting fee is simply a bid for that shelf space. The assumption is that the highest bid is also associated with the individual company that is in the best position to generate the greatest returns through providing products in the form and variety most desired by consumers.

Demand and supply apportionment is also another explanation. Here we see slotting fees being suggested to help equate the supply of new products and their demand by consumers. An assumption underlying this explanation is that there's been an oversupply of new products, increasingly new products being offered to the trade. Many of these lack the type of true innovations that are associated with "new" products.

Slotting fees here are a mechanism that is used as a basis for incenting retailers to accept these products that they might not otherwise, therefore providing an opportunity for new products to enter the marketplace. Overall, all of these mechanisms of efficiency can be identified as facilitating practices for lowering retail prices by simply adding efficiency to the distribution channel.

A second dimension of the final explanation is that the slotting fee is a basis for unbundling the cost of the shelf space from the cost of the product, thereby reducing the price paid by retailers and allowing them to compete more aggressively in the downstream market.

The other school of thought is that slotting fees are a tool for enhancing market power and undermining competition. In this respect, a variety of explanations suggest that slotting fees are associated with the exercise of market power in a variety of different ways. Generally, slotting fees are thought to reflect the exercise of acquired market power on the part of retailers toward manufacturers.

As a result of consolidation, technology infusion into the retail marketplace, and a proliferation of new products, the argument is that retailers have achieved a higher level of market power, and slotting fees are simply a mechanism for exercising this power upwardly through the distribution channel.

A second explanation is that slotting fees enable retailers to discriminate among manufacturers, particularly large versus small firms. Because of the private and negotiated nature of slotting fees, retailers are said to be able to ask for and receive disproportionate payments from large and small manufacturers. In addition, retailers large and small are also distinguished in terms of their ability to acquire fees from upstream manufacturers.

A third explanation under the market power school is that slotting fees are a competitive mechanism that enables larger and more resourceful competitors to foreclose smaller rivals from access to required inputs, such as retail shelf space.

Here shelf space is viewed as an essential input to the distribution process, and through bidding up the price on the part of an aggressive competitor, they're able to raise the cost of rivals in terms of their ability to acquire that shelf space, thereby foreclosing them from the market.

A fourth explanation of the market power school is that slotting fees have damaged manufacturer and retail relationships, leading to overall concerns for channel efficiency. The idea here is the acrimony and conflict associated with the slotting fees and practices has created such dysfunction that it has led to concerns for the interaction between manufacturers and retailers who are ostensibly positioning the channel to enhance one another's offering to consumers.

One explanation of this, or one illustration of this, is the effect that this dysfunctional conflict has had on the consumer information. Many manufacturers view the slotting fees as simply a practice that they need to address, and they thereby often shift funds -- or it's said that they shift funds -- out of their downstream promotion budgets to compensate and pay for these fees.

Finally, overall, these explanations are viewed as a facilitating practice for raising retail prices through diminishing retail competition. The second dimension of that argument is that the up-front payment and the positive impact of slotting fees on retailer profits diminishes the incentive for retailers to compete aggressively in the downstream market, leading to higher prices.

In asking managers to provide us with feedback on various aspects of these explanations, our findings, as you might imagine, were mixed. In the matrix here, you can see how manufacturers came out in terms of their tendency to agree or disagree with aspects of each of the explanations compared to retailers. Let me focus your attention to the upper left-hand corner where we find agreement on both the part of manufacturers and retailers; that is, both manufacturers and retailers agree as to these explanations.

On the efficiency side both manufacturers and retailers tended to agree that slotting fees did help shift the risk of new product introductions in the marketplace back to manufacturers, and as well that they helped to apportion the oversupply of new products to a less than commensurate demand on the part of consumers.

At the same time manufacturers and retailers agree that slotting fees were associated with the exercise of retail market power, were also associated with discrimination in terms of practice, and that overall were a facilitating practice for raising retail prices. I have to throw in a caveat here again to indicate that these are the opinions of manufacturers and retailers and we need to characterize the results in that respect.

Overall some of the conclusions that can be drawn are identified here. In terms of nature and usage, what we're really dealing with is a family of practices. Slotting and display fees appeared to be most common on the part of the sample that we surveyed, but all different types of fees are found in the marketplace. Overall some manufacturers appear to be able to negotiate these fees, and not all appear to be paying the same amount, according to the opinions of manufacturers and retailers.

We found that the application of slotting allowances varies across the different product categories. Overall trends include one that retailers are more likely to require all of the fees. The policy and practice has become more formalized, with a limited increase in negotiation, but still written contracts are not commonplace. The fees themselves are suggested to no longer be limited to new products. Again, manufacturers provided a yes to this answer. Retailers were more neutral.

A variety of different factors have led to the use of slotting fees, and while the explanations vary, there appears to be some support for both schools of thought as they relate to the role of effective slotting fees.

Thank you very much.

MR. BALTO: Thank you. I'm David Balto. I want to start off with a couple housekeeping notes. First, there is an overflow room in 332. Second, for those of you who missed the handouts, we'll make extra sets for you. Third, if there are any professional golfers here who think this is the place to register for the Kemper Open, you're sadly mistaken.

I'm here to tell about what the FTC's been doing the past several months on the slotting allowance project. Antitrust, it's always said, is a process of sort of rolling up your sleeves and getting to know the facts. That's what Neil, Chris and I have been doing for most of several months.

But just to give you a little background, as many of you know, this has been an area of intense congressional interest. There have been congressional hearings both before the Senate Small Business Committee and the House Judiciary Committee, and Will Tom, our former Deputy Director, testified before the House Judiciary Committee. We've worked closely with the Hill staff, and I want to express our thanks to Paul Conlon and Damon Dozier of the Senate Small Business Committee who have assisted us greatly during this project.

Let me say something at the outset, an important thing about the antitrust laws. We're talking here about distribution practices, arrangements between manufacturers and retailers, and when antitrust looks at those practices, we take a balanced approach. There are really relatively few rules of per se legality and per se illegality. We look at most cases under what's called the Rule of Reason, and we ask ourselves whether or not the practice ultimately harms the overall level of competition -- whether or not, because of the practice, there are higher prices, less choice or less product innovation.

And the purpose of the antitrust laws, a well known maxim, is "to protect competition and not competitors," so the elimination simply of one competitor from the market does not necessarily raise antitrust concerns.

What have we done for the past several months? Well, we looked and we saw there was relatively little scholarship on the subject, there was relatively little empirical research. So we went out and we chose five product categories to look at, and we picked these categories because they're very different in nature. Some of them had products that turned over frequently. Some of them were products that turned over slowly. Some of them were markets that seemed relatively competitive. Some of them seemed more like dominant firm categories.

And for those five products, we went and spoke to every manufacturer, and with very few exceptions, the manufacturers were all willing to talk to us. Then to really get to understand some of these product categories, we went and actually visited the manufacturing facilities to understand what the economies of manufacturing the products were.

But then there was the other side of the equation, the retailing side of the equation. We visited retailers, both large and small, in about eight states, and we spoke to most of the largest retailers in the United States. We asked them not only about these product categories but about their general practices and policies involving slotting allowances, and when they took us through their supermarkets, we went category by category through the stores and they told us how slotting allowances affected their decisions about which products to choose and which products to market.

Let me emphasize, that in this matter, like any other FTC inquiry, confidentiality is totally protected. We researched this at the beginning, and we determined that there was no way that anyone could discover the names of the individuals we spoke to, so we assure absolute confidentiality to the people who participate in our inquiry.

Of course, there are other slotting inquiries going on at other federal agencies.

Let me talk about our own study. What are the key questions we've been asking? Well, our first question is, what are the terms of the agreement? Then what is the market context? What's the likely competitive impact, and if we determined ultimately that the impact was anti-competitive, what remedies were feasible or appropriate?

In terms of the agreement, we asked the kinds of questions you would expect and the kinds of questions we'll ask during our first panel. Were slotting allowances for a right to get into the store? Were they related to a specific amount of shelf space? Are slotting allowance for preferential shelf space? Are they used by exclusive or dominant suppliers? Are they used to go and place other suppliers in an inferior position? And of course, like any kind of agreement, we look at the duration of the agreement to determine whether or not it's anti-competitive.

The market context is critical, and here we asked two questions. Were these allowances offered at the instigation of the manufacturer or the retailer? And once we asked that question, we asked ourselves, What were the markets like? Were the manufacturing markets competitive, or were they dominated by a dominant firm, or did they involve new entrants? We asked the same question on the retail side of the equation.

Now, as Greg articulated so well, there are many procompetitive rationales, and we heard from the retailers that there are scores and scores, hundreds of new products that are presented to them every day and that slotting allowance oftentimes serve as a mechanism for which they can differentiate between those products that are likely to be successful and those products that are unlikely to be successful. They also served other interests such as guarding against risk.

Of course we also heard from manufacturers, numerous manufacturers about concerns over exclusivity, and exclusivity of course can be a serious concern. Of course, under the antitrust laws, exclusivity does not have to be 100 percent to raise competitive concerns, but it's most likely to be a problem where it involves exclusivity over critical distribution outlets and it's for a significant period of time such that the excluded manufacturer really is significantly harmed, unable to effectively compete.

If we determined that there is a likelihood of competitive harm but also some likelihood of efficiency, we have to ask ourselves whether or not there are less restrictive alternatives that the retailer can use to achieve the same efficiencies, and here we asked retailers about the use of failure fees or other promotional funds that might both signal the likelihood of success and also account for the potential for risk.

There's the issue of category captains which Neil will talk about in just a minute, and also one of the ultimate questions we had to grapple with, what are the possible consumer benefits? Well, slotting allowances may lead to more product introduction, and it may help the retailers who lack information to determine what are the products that consumers most desire. On the other hand, there are possible consumer harms both from increased prices, decreased product variety, and decreased product innovation.

The hard question, of course, is if you determine that there is a competitive problem, what would be the appropriate solution? If slotting allowances were banned, would we see similar types of practices which would lead to the same kind of anti-competitive results, or would we see that promotion programs would turn to more efficient formats that are more likely to benefit competition.

One thing we frequently do here is supermarket merger enforcement. It's one of the biggest parts of our merger enforcement. In fact we bring the second largest number of our cases in supermarket merger enforcement, and one of the concerns that we've heard from a number of sources is that slotting allowances are only a symptom of greater problem of retailer market power on the buyer side, and that that should be an issue that should be considered in our supermarket merger enforcement.

As Neil will explain, we'll grapple with that issue over the next two days. And now it's time for me to turn this over to Neil who will give you the format of today's program.

MR. AVERITT: Thank you, David. I've got a pleasantly transitional task to perform here. We've heard a very comprehensive background description of slotting allowances and of the factors that may lead to their use. We have coming up a workshop that's going to have a number of people with very diverse backgrounds and with good expertise.

My remarks right now are intended to bridge between these two phases of the workshop and to tee up some specific questions which we hope the members of the workshop can begin to revolve in their minds. These are questions on which it will be very helpful if we could have your thinking.

To give a patina of rationality to all of this, we propose to divide the workshop into five different panels, one later this afternoon and four tomorrow. These panels will take up different, more or less distinct aspects of the slotting allowance issue. You can see the five of them there.

Let me take a moment to talk about the similarities and differences in Panels 2 and 3. Those two panels will be discussing two theories that have been advanced as to what slotting allowances are all about.

Panel 2, "Exclusion and Exclusive Dealing," will take up the hypotheses that slotting allowances are brought about at the instigation of large manufacturers with great financial resources, who are using slotting allowances to buy shelf space, to exclude competitors, and thereby perhaps to acquire market power. This wouldn't happen in all cases necessarily, but, the theory goes, this might help in some cases, and it's something worth watching for.

The third panel will take up a different theory that's been proposed -- that slotting allowances are instead a manifestation of retailer power, that some retailers have acquired market power at least as exercisable upstream toward their suppliers, and have elected to exercise this power through slotting allowances. Again, the theory says this isn't always the case, it doesn't necessarily happen that way, but it happens often enough to be of concern.

Let me note two qualifications at this point. One, by putting these theories on the table we're not necessarily expressing any view as to whether they're true or false. These are merely issues to be explored in the workshop, and we value your thoughts on them. Second, by setting these two theories up in two different panels, we don't mean to imply that they exist in watertight compartments. Obviously they can exist in various combinations and balances.

So those should be the main panels and the basic structure of the workshop.

Let me take a minute now and run through some of the specific questions that you might want to consider in each of the panels.

Panel 1 is on "Types, Trends and Effects of Slotting Allowances." That will be the panel of the people around the table now, and the panel that will meet later this afternoon. It will be in some senses a discussion of the same issues that we've been hearing about for the last 45 minutes, but at greater length and in greater detail.

There are a number of specific questions that are presented by this topic. What are slotting allowances? Are they for new products? Are they pay-to-stay fees? How are they negotiated? Are they always used? What do these things tell you about the purposes and effects of the allowances? Are the allowances intended to cover or reimburse retailer costs in taking on a new product?

If to reimburse costs, what kind of costs are involved? Is it the management cost of reprogramming computers, or the labor cost of resetting the shelves physically, or the business cost of risk of product failure, or the opportunity costs of not taking on some other product that might have done better? Were those costs identified? Do the slotting allowances match up with them? Do the costs explain what the allowances are all about?

How closely do the allowances follow the costs? Do the costs explain the allowances, or is there still some increment in the allowances that would need to be explained in some other way? What effect do the allowances have on the consumer demand? Do they increase it? Do they depress it.

And finally, what becomes of the slotting allowances? How does the money go? Is it used to reduce the price of the product? Is it used to reduce the price of some other product in the store? Is it reprogrammed by retailers to cover overhead expenses like physical facilities or bigger parking lots? Or can the slotting allowance be kept simply as profit?

And that should bring us to the end of today.

Panel 2 will then convene at some shockingly early hour tomorrow morning and will take up "Exclusion and Exclusive Dealing." This is a panel that will look at the hypothesis of aggressive exclusionary conduct by large manufacturers. An initial question to be considered is, does this type of manufacturer conduct raise the capital cost of entering a market or of remaining in the market? Are slotting allowances a significant increase to the cost of doing business? If so, does that tend to squeeze out less well financed competitors?

If so, can the capital markets respond to make money available to those competitors? Are there less exclusionary alternatives, as Dave Balto was discussing, by which manufacturers could perform whatever necessary functions that are performed by slotting allowances without raising the capital-cost bar so high?

And then the later questions that this panel might want to consider would ask whether there are any more overtly exclusionary practices in play beyond simply raising capital costs. Have some manufacturers bought additional or preferential shelf space? Have they bought outright exclusivity?

And then finally we reach the question that's the jackpot question for any antitrust inquiry: What effects, if any, does any of this conduct have on competition? In other words, exclusionary conduct is not necessarily a problem if only some firms are excluded but if the market remains competitive, but that's a question we have to look into. Have the markets in fact remained competitive?

Here the panelists might want to look at those questions from two different angles. Is the market price competitive, a traditional inquiry of antitrust law, and you might also want to consider, Is the market competitive in other non-price terms such as variety and innovation and consumer choice. That will bring us then to the tend of Panel 2.

The third panel will convene later tomorrow morning and will look at the second theory to be tested, and that's the theory that a slotting allowance is some sort of manifestation of some underlying retailer market power.

Here the story to be examined is that retailers have market power, at least exercisable upstream, having possibly acquired it through mergers, and have elected to exploit that power through slotting allowances. Again, we have no opinion about whether this hypothesis is true or not, but it does raise some questions.

Do slotting allowances and does the structure of the market in fact suggest the possible existence of general national power among supermarkets? What is the national concentration ratio in the supermarket business? How does this compare with other industries?

Now, if it doesn't appear that supermarkets have power on a general national basis, is it possible that they have it in some more specific circumstances? Might they have it, for example, in a potential way which could be exercised if they began to buy more centrally, if they stopped buying through independent warehouses or divisions and bought according to a central program?

Or might supermarkets have market power in certain local geographic markets, even if they don't have it nationally? In other words, could there be certain products that will trade only within a certain narrow geographic range, possibly perishable products that can't be shipped very far, and could supermarkets have market power against the suppliers of those products even if they don't have it generally?

So those are probably the substantive questions for the "retailer buyer power" panel, leading up at the end to the question of remedy. That question is, If there appears to be a problem here, is the remedy one that we ought to seek out in terms of slotting allowance doctrine, or is it a remedy we should look for in terms of our merger enforcement policy? And a component to that question might be, Which avenue of remedy would allow the simplest and clearest and most effective remedial action to be taken?

We'll break for lunch at that point, and then when we reconvene tomorrow afternoon, the topic will be category management, which has been alluded to a couple times this afternoon. It will begin with a question, What is category management? Is it, as generally described, simply a practice of disciplined and quantified study of product movements, giving a disciplined and quantified way of allocating shelf space, or is it something else?

Then what is the role of the category captain? Is that, as commonly described, a manufacturer, usually the largest manufacturer in a product category, who's designated by the retailer to provide advice on the management of that category? Is that the role or is the role something else?

Then does the role of the category captain present antitrust issues of its own? In some sense category management and category captains is an approach that competes with and is to some degree a substitute for slotting allowances. It's an alternative way of picking products and allocating shelf space, perhaps. But does it raise questions of its own?

For example, the category captain gives advice vertically down the distribution chain to the retailer. Does that create any possible issues? Could that advice be biased in a way that lets the category captain give a preference to its own products and to exclude or recommend against the products of other manufacturers?

And then if so, what does that mean? Does the retailer have a way of knowing whether this is going on? Would the retailer be able to control for this problem if it were to exist, and would the retailer be motivated to control for it in the first place?

Category captains can also raise horizontal issues at both the manufacturer and the retailer level.

At the manufacturer level, the horizontal issue can come up because a category captain is after all a supplier, one of several competing suppliers of a particular product. In its role as category captain, it communicates with the retailer, and the possibility exists that the retailer will be giving information back to the category captain about what other products, what other manufacturers in that category are doing. Then the question is: Is this sensitive, competitive information? Does it create competitive problems? Is it a practical problem in the first place, or does this involve the kind of information that circulates, the sort of things that will be generally known in the industry in any case? "No harm, no foul," perhaps?

Then, finally, there's a possibility of

horizontal information exchanges at the retailer level. If you have one firm that's going to be the category captain to several different retailers, the possibility exists that that firm can be an intermediary, conveying information from one retailer to the other.

The questions would then exist: Does this occur? Could it occur? Is that likely to be a practical problem? Or instead, is it more likely that different retailers will choose not to have the same firm as a common category captain? Would they prefer perhaps to have their own category captain who would be devoted more particularly to their own interests? Interesting issues to resolve.

Finally, having, I'm sure, about as many interesting issues as we can deal with we will come to Panel 5, which will be "Policy Recommendations." This is going to be a panel to try to pull together the law, the economics and the business information that's been developed over the previous day and a half, and to convert it into recommendations of further studies for the Commission staff or possibly further action for the Commission itself.

What, if anything, should be done about slotting allowances? (A compact bottom-line question.) What, if anything, should be done about category captains?

Should our merger enforcement policy become more active in this area? Should we take more account of buying power? And finally, would guidelines be useful? Is that a sensible next step to consider?

So that should be the outline of, I think, a very interesting, very productive day and a half. We're immensely grateful for all of you for being here, to the people who will be participating in the five panels, to the other people who are attending and observing. I hope you all enjoy the hours ahead.

Let me close with two administrative matters. First of all, we'll take a 15 minute break at this point to reconfigure everything.

MR. BALTO: Why don't we make it ten minutes.

MR. AVERITT: A ten minute break to reconfigure things for the first panel, and then second, we would invite all of you to attend a reception at the end of the day, which will be held upstairs in the Top of the Trade cafeteria. So we'll look forward to an interesting panel and then to seeing you all upstairs. Thank you very much.

MR. BALTO: We'll start again at five minutes after three.

(A brief recess was taken.)

PANEL 1: INTRODUCTION TO THE MECHANISMS, TRENDS, AND EFFECTS OF SLOTTING ALLOWANCES

PANEL 1 MODERATORS

DAVID BALTO, FTC
SUSAN DESANTI, FTC

PANEL 1 GUESTS

DON SUSSMAN (Ahold)
PETER DE LA CRUZ (Attorney)
DAVID NICKILA (Portland French Bakery)
SCOTT HANNAH (Pacific Valley Foods)
WINSTON WEBER (Consultant)
AKSHAY RAO (University of Minnesota)
MARK DENBALY (ERS)
JAY CAMPBELL (Associated Grocers)
ROBERT UKROP (Ukrop's)
GREG GUNDLACH (Marketing academic)
JOHN EAGAN (Costco)
BOB HOUCK (CoAMS)
BART WEITZ (Academic)
STEVE SALOP (Transition Speaker on exclusivity)

MR. BALTO: If everyone would try to take their seats. Again there are seats in room 332. I'm David Balto. Along with Susan DeSanti, we're going to moderate today's panel. I want to give you our ground rules as moderators. We're tyrants. The way you are recognized to speak is for you to lift your name tent in a vertical fashion and then to wait for us to call on you. When you're called on please identify yourself, if we haven't already identified you, so that the court reporter knows who you are. As far as we can tell, you have no lifelines in this endeavor. You cannot call upon the audience, and you can't phone a friend.

Let me start off by having us each identify ourselves, both for the audience and for the court reporter, doing this clockwise starting with Susan.

MS. DESANTI: I'm Susan DeSanti, Director of Policy Planning at the Federal Trade Commission, and when you identify yourself, please give your affiliation. Thank you.

MR. NICKILA: Hi. My name is Dave Nickila from Portland, Oregon, 50 percent of owner of a small bakery called Portland French Bakery.

MR. UKROP: Good afternoon. My name is Bobby Ukrop. I'm president and CEO of Ukrop Supermarkets, a 27 store retail chain in Richmond, Virginia.

MR. GARMON: My name is Chris Garmon. I'm from the Bureau of Economics at the Federal Trade Commission.

MS. SULLIVAN: I'm Mary Sullivan, and I am an economist at the antitrust division of the U.S. Department of Justice.

MR. RAO: My name is Akshay Rao. I'm a professor of the business school at the University of Minnesota, not to be confused with the governor of Minnesota.

MR. WEBER: My name is Win Weber. I'm president of Winston Weber & Associates. We are a management consulting firm. We work with retailers as well as suppliers worldwide in the areas of category management and collaborative relationships between both retailers and suppliers.

MR. SUSSMAN: My name is Don Sussman. I'm executive vice president of purchasing and supply chain of Ahold U.S.A.

MR. GUNDLACH: Greg Gundlach. I'm professor of marketing at the Mendoza College of Business at the University of Notre Dame.

MR. DE LA CRUZ: I'm Peter De La Cruz with the Washington, D.C., law firm of Keller and Heckman.

MR. CAMPBELL: Jay H. Campbell. I'm President and CEO of Associated Grocers in Baton Rouge, Louisiana. Associated Grocers is a retail-owned company that distributes grocery foods and merchandise to independent retailers.

MR. HANNAH: My name is Scott Hannah, CEO of Pacific Valley Food, Bellevue, Washington, primarily frozen vegetables and potato products.

MR. HOUCK: My name is Bob Houck. I'm Vice President of Strategic Planning with CoAMS, Incorporated. We're in Chicago, and we manage and consult on co-op advertising and trade promotion programs.

MR. AVERITT: I'm Neil Averitt, an attorney on the staff of the Federal Trade Commission.

MR. DENBALY: My name is Mark Denbaly, Economic Research Service of the U.S. Department of Agriculture.

MR. EAGAN: John Eagan, vice president and senior general merchandise manager, Costco Wholesale, Los Angeles region.

MR. WEITZ: I'm Bart Weitz. I'm a professor at the University of Florida.

MR. BALTO: And I'm David Balto with the Office of Policy and Evaluation. Our goal today is to go over the basics of slotting allowances to get some sense of why slotting allowances are required, what purpose they serve, and how they've changed over time.

I want to start off today by asking Don Sussman and Jay Campbell about why you use slotting allowances. Don?

MR. SUSSMAN: A number of reasons. First, we think that slotting allowances help us defray the real costs of bringing new products onto our shelf. There are really costs associated with putting the products on to our store shelves physically, changing our store shelf planograms, putting the new items into our computer systems, and physically onto our and into our warehouse. These are real costs that we incur. Slotting does help us defray the cost.

The second reason is risk. There's the risk of that new item that we bring on fails. There's no proven track record on new items. There's also the risk involving the item that we discontinue to make place for the new item. That existing item has an income stream associated with it. When discontinuing that item we lose our income stream and also the customers that have bought this item in the past can be somewhat disenfranchised, so there's both risk of the new item failing and risk of giving up the existing item.

The third reason is there an income stream associated with slotting. This income stream does help our profitability, and we treat this in Stop & Shop and in Ahold as another form of gross profit. Every dollar of slotting that we generate is an item -- is a dollar that we don't have to generate from the customer.

We have a budget. We have a certain amount of return we need for our stockholders. The more slotting we have, the less pressure there is on pricing.

The fourth reason is variety. I just want to say that we have slotting that would be considered in the industry on the high side. We acknowledge that. We also think we have the best variety, one of the largest varieties on a category-by-category basis in the industry.

We think more manufacturers are able to find room on our shelves for their products -- both small, diverse manufacturers as well as large manufacturers. We carry more items. That's not the most efficient model, but we think it does the best job of satisfying our customer. There is a cost to that. We think the slotting fees help us offset the cost.

MR. BALTO: Thank you. Jay?

MR. CAMPBELL: We are very similar in the sense that we have the need to add new items, to broaden our selection and variety of offerings to our independent retailers. The major difference is that we bear the risk ourselves since we are a wholesaler. We do not have the avenue to force it downstream into the retail outlets.

Therefore, the definition of slotting to us is a slot in the warehouse, and we use slotting to make available space for a new item to start the distribution process, and then we likewise bear the risk of loss on that item as well as the risk of the item that we currently have that it will be replacing.

Then we have to make plans of distributing that item through a network of stores where they are free to buy or not to buy that particular item. Our job is to ensure that we get information disseminated out to the stores to ensure that they are interested in trying to put it into their network at the retail level.

For us it is not really a profitability issue as much as it is a cost coverage issue. Obviously it becomes a profitability issue if you don't cover your cost. It becomes a negative profitability issue, but slotting has served that purpose very well so that we are constantly encouraged to add new items because it does cover the cost of introduction and distribution of new items.

MS. DESANTI: Could I ask a couple follow up questions? Don, I was wondering, could you speak a little bit more about the cost of new product that are associated -- that you associate with new product introduction? And also a follow up question: Do you only use slotting fees in connection with new products?

MR. SUSSMAN: In terms of the cost, it differs by category. It differs by item, but if you want me to list the items, I'm not going to list the individual costs, but typical ones.

MS. DESANTI: Typical.

MR. SUSSMAN: New items are presented to us. We then have to discontinue existing items, which means taking the physical product out of the stores and out of the distribution centers. The new item rarely goes into the same shelf location as the old item. Either they're a different size, or it's a different piece of the subcategory, which means a planogram change. A planogram change has to be executed in each of our stores. That takes people. It takes money to do that, plus the disruption to the business while it's being done.

Our warehouses, same thing. We have existing products in there that have to be discontinued. New item haves to be received, have to be put away slots in the warehouse have to be made, and they don't always go where the existing product goes. The new item might be a lighter case than the other case, so again we have to redo our warehouses somewhat to accommodate the items.

All these things are real costs that happen over and over in each of our stores, happen in each of our warehouses, and happen each time a new item comes into the process.

MS. DESANTI: Do you only use slotting in connection with new product entry?

MR. SUSSMAN: That's correct.

MR. BALTO: Don, let me follow up. Does the amount of slotting fee vary by item depending upon what you estimate the costs are?

MR. SUSSMAN: First of all, I'm going to be talking mostly about Stop & Shop, which is the largest division of Ahold U.S.A., and it's where I've worked the last three and a half years until January. That's really what I'm knowledgeable about, so my answers will use Stop & Shop as a frame of reference.

I'm sorry, the question?

MR. BALTO: So my question is: Do they vary per item based on the specific cost that you --

MR. SUSSMAN: Yes, they do. We have different slotting guidelines in each of our categories depending on the size of the item, the amount of shelf space it takes, the turnover on the item, the category growth of the item.

Largely they're somewhat historical. They're not in a lockstep with the costs associated with the items, but they are generally following the costs associated with handling items. Larger bulkier items tend to have higher slotting costs than smaller high profitable items.

MR. BALTO: If any of the consultants want to offer an opinion on any of these items, just let us know.

MS. DESANTI: Why don't we give the consultants an opportunity to speak in their experience --

MR. BALTO: Right.

MS. DESANTI: -- What have you seen?

MR. WEBER: Win Weber, and since we consult for a broad range of retailers across the country, we see various behaviors. If we take a Stop & Shop, exactly as Don has said, in a regular practice, they cost out their cost appropriately by category and by item. We see other retailers who frankly request slotting allowances who frankly do not figure out the costs as precisely as a Stop & Shop would, but in fact try to get as much from the manufacturer as they can.

We have other situations where our retailer clients do not charge slotting allowances but will accept slotting allowances if offered by manufacturers.

And we have one situation we've been tracking for five years now, where a client of ours asked all suppliers to sign a letter, and if the offerer signed a letter stating they were getting all possible allowances, they would not charge slotting allowances.

That has grown to where we have 40 percent acceptance of that policy, where an officer of the company, a manufacturer, will say, You are seeing all of the possible allowances, and therefore they will not ask for the slotting allowances. The buyer will then ask for slotting allowances from those manufacturers who in fact are not willing to sign, because we're dealing with the fundamental issue here, and that is any buyer or any category manager is being paid to make sure that they get the best or equal to the best cost in the marketplace.

And today in the industry it's very hard to find out what those specific costs are, so there are various pressures that the retailer is working under and the manufacturer is working under. That's why we see many types of menus, I guess, of how this works.

MR. BALTO: Mr. Weber, is there some reason these firms take these different approaches? Is there something -- some characteristic that you notice? Does it relate to what kind of market power they have in individual markets? Does it relate to what part of the country they're in, anything like that?

MR. WEBER: I think you see slotting allowances more prevalent in some areas of the country. You have companies with different philosophies. You have companies that account for their allowances differently. You have differences -- some who are everyday low price retailers, versus high-low retailers. So there are different philosophies of conducting business, and I think that's the best way to look at it.

MR. BALTO: Mr. Weber, how have slotting allowances changed over let's say just this past five years?

MR. WEBER: Well, I've been listening to the indications of slotting allowances over the last ten, and frankly, when I worked on the manufacturer side, I was paying slotting allowances in 1979. So I think, let's put slotting allowances in perspective. This is a 20-year phenomena or more, and in that context I think that I haven't really seen any significant changes over the last five years, to be frank.

MR. BALTO: In the amount of slotting allowances?

MR. WEBER: The amounts are in a relative ball park. I've seen the size $25,000 for multiple-store chains. I see slotting allowances paid based on one free case per store instead of dollars. I've seen it as high as two free cases per store because then the manufacturer can work off a cost of goods basis and it's less expensive for them, so there are ways that these things are served up, and I would look at no standard.

MR. BALTO: Mr. Sussman, how have slotting allowances changed at Stop & Shop over the past several years?

MR. SUSSMAN: Basically our category rates have been frozen for the last two years. Our business has grown, so overall I would say slotting has not grown as fast as our overall business has grown.

MR. BALTO: Mr. Campbell?

MR. CAMPBELL: From an amount standpoint?

MR. BALTO: Yes.

MR. CAMPBELL: No difference.

MR. BALTO: So they've been stable for how long?

MR. CAMPBELL: Five years.

MR. BALTO: Mr. Houck, do you have any observations of the trends of slotting allowances or why slotting allowances are used?

MR. HOUCK: I would like to comment on something, the opposite side of what Mr. Weber was talking about. Many retailers might say, You give me all -- something equal to the total amount of allowances, and then I won't ask for slotting. Something that I've heard about a lot on the manufacturer's side is the flip side of that, which is that some manufacturers, if you asked them how much they're paying in slotting allowances, they really don't know, because they are looking more in terms of giving their sales reps a blanket percentage of allowances that they could deal with, and it's up to the rep to break it down any way they want.

So the rep may have 12 percent of the sales price to play with. He can break it down as 3 percent for slotting allowances and 9 percent for volume rebate or any way that he wants to. The manufacturer doesn't care as long as he stays within the guideline percentage.

MR. BALTO: Can I have an observation by either the consultants or the retailers, how do slotting allowances differ from other forms of product promotion, and how are they similar? Don, do you want to start?

MR. SUSSMAN: Well, what makes slotting allowances different is that slotting is an up-front payment for the introduction of a new item, and that's the end of the slotting allowances. Other forms of promotion, say when you run an ad, is that every time you run an ad you receive the ad fee. Slotting is a one-time happening.

In the Ahold world, certainly the Stop & Shop world, the manufacturer pays the slotting. The product gets on the shelf, and from then it depends on how well that product reforms. It could be on the shelf for the next ten years. An ad fee or other fees, say an ad fee, comes every time we run an ad so it is recurring every time that event reoccurs.

How are they similar? For us they're all forms of income, and they all go to the same pot, so we try not to worry about what pot they come into. We have got a sales and a profit budget, and like I said before, the more we are able to generate from one source, the less pressure there is to generate from other sources.

MR. BALTO: Jay or Bob Ukrop, do you have an observation about this, how they're similar or different from other forms of promotion?

MR. CAMPBELL: I don't really consider slotting from our perspective to be a form of promotion. It's really in our world a cost coverage item for the introduction of new items. It's not going to impact the way we go to market with an item. When I look at promotion, it's how we're going to market with an item from a marketing standpoint and from a promotional standpoint.

Those are going to be different types of funds that a manufacturer may make available. In most cases those things are done as the gentleman down here said, through a pooling of funds that are done on an allocated basis, and that's what your allocated pool to go to market is.

MR. BALTO: Win or Bob Houck, do you have an observation about how slotting differs from other forms of promotion?

MR. WEBER: Bob, you want to go first?

MR. HOUCK: Sure. I agree that it is not promotional. It is a cost coverage or something associated with getting the new product into the store. However, looking at it in terms of how it is done in different ways in other industries, the same thing, typically in other industries, other than grocery, you will see that it is usually covered through some sort of an introductory allowance which would be in excess of the normal trade promotional allowance.

So, for example, if you were introducing a new product in the apparel field, you might have a 5 percent co-op allowance on that product, but during the first three months or six months, you might offer 15, 20, 25 percent allowance, which would cover the cost to the retailer of promoting that product during the introductory period and give an early allowance to the retailer.

So that would be how it would differ in other industries and how it would be the same as to some extent. They're still covering the risk for the retailer of taking on a new product and promoting that new product for them.

MR. BALTO: Win?

MR. WEBER: Basically the menu of allowances that manufacturers offer are designed to drive the market share of their brands, consumption. Hopefully there's a pass-through to the consumer of X percentage of every dollar. Slotting allowance is basically going into profit, I guess is the way I would look at it, for many of the reasons that have been discussed.

MR. BALTO: To --

MS. DESANTI: Scott Hannah?

MR. BALTO: Scott, I'm sorry.

MR. HANNAH: I'm going to take a different track. Slotting allowances are bad. They're evil. Two things.

I'm not going to sit right now and answer all these arguments from the retailers, but number 1, the consumer loses, and that's the first thing we should all think of. The consumer loses.

Those slotting allowances are very expensive. They're more expensive than the trade advertising that we do, the displays, the ads, the shelf talkers. They're much more expensive than media advertising we do. They have to be built into the cost of the product. They add no value to the product. The consumer loses.

The second point is that it's very detrimental to small and medium size business. I've worked for the big corporations. I've been with P&G, Bristol Myers, had my own small company. If you're a big conglomerate, you can take that slotting allowance and can spread it over a hundred, 500 items in the store. There's no way that you as a small manufacturer can come in with a few items and charge that slotting allowance against your proforma. It is impossible.

Thank you.

MR. BALTO: Scott, we're going to get back to that. I wanted to -- let me turn it around a little bit. Is there anybody here who can tell us that slotting allowances are no more than a discount off of price, that ultimately they result in lower prices to consumers?

MR. SUSSMAN: Say it again, please.

MR. BALTO: Is there anybody here that can tell us that slotting allowances are no more than a discount off of price, that ultimately they result in lower prices to consumers?

MR. EAGAN: Yes, in my world that's --

MR. BALTO: Identify yourself.

MR. EAGAN: John Eagan, Costco Wholesale. We don't ask for slotting allowances. What we do is see what part of that menu they're on, or see what the amount of the menu they represent, and we look for other ways to do it. But everything in our world goes to the net landed cost of the product. So we have an allowance that goes to lower the cost of the goods that we recorded in our books, and we work on the margins based upon what our net landings are.

So if they called it slotting allowances, it just goes in as a discount to lower the net landed cost for us.

MR. BALTO: Why don't you explain this a little more. At Costco, do you accept slotting allowances or do you just make them change the wholesale price?

MR. EAGAN: We don't even ask the question, Is there a slotting allowance here? What we do is say, Are you paying other discounts or what is your menu of discounts, and if slotting allowance is on there, we want to get the same bottom line. We want to get the same landed cost or the lowest cost the manufacturers offering in the marketplace.

Whether they call it a slotting allowance or advertising allowance or promotional allowance doesn't make a lot of difference.

MR. BALTO: But back to the supermarket, can you make the case that slotting allowances are no more than a discount that results in lower prices to consumers on those items?

MR. CAMPBELL: I think you're talking apples and oranges. If you don't have the slotting allowance you're still going to incur the cost of introduction of the item, the distribution, setting up the item, doing the planograms and doing the retail space shelf allocation. So somebody bears the cost, and so it's going to be flowing through at some point.

If it's done by the distributor, done by the retailer or done by somebody in the chain, it's going to happen.

MR. SUSSMAN: I would take the macro view that in total those slotting allowances, all streams of income help lower cost, and if they weren't there, the pressure on prices would rise. Our manufacturers bottom lines are a multiple of what most retailers are. There's no guarantee that, if the manufacturer didn't pay that, their bottom line wouldn't go up even higher.

In order to maintain our bottom lines we would have to raise our prices, so yeah, we look at slotting allowances, all forms of income as a way of holding down our retail pricing.

MS. DESANTI: Bobby.

MR. BALTO: Identify yourself.

MR. UKROP: Bobby Ukrop from Ukrop's. We're trying to serve our customers, and we want to give the customers the items they want. If a smaller manufacturer comes to the table, and I don't know how they do it at the other companies, but like they can't pay, they can't afford it, and so we would try to help like a Virginia company, a smaller company.

I imagine the other companies do the same thing, that you try to give a person a chance to sell their product. Those people don't have the money to pay like the bigger companies do as a practice. However you deal with the menu, the menu's there, but somehow I guess we can't forget about the customers. In this process, it's the effort to try to generate the income, the revenue that comes from these allowances, though we also have to keep in mind that the customers should have the opportunity to have some variety they might not otherwise have if we didn't allow the smaller manufacturers to get in the game without paying the slotting allowances, because for some people, there's no way they can afford to do it.

Even yesterday we had somebody come and want us to sell sweet potato muffins and sweet potato cookies from their recipes. Just a couple items this couple wanted to try to sell, and there's no way anybody would give them the time of day if they had to pay slotting allowances.

So I think in some cases you don't. Even though there's some cost associated, if you put those products in, then you perhaps will make that up on others who will pay, so you can again have the items that your customers will want.

MS. DESANTI: Let me ask a followup because, Don Sussman, I think you connected slotting allowances with increased variety in your stores, if I understood you correctly, and I was wondering if you could speak to his points.

MR. SUSSMAN: I was making a point that if slotting led to less variety, I don't think you would find a correlation between the higher-slotting-charging supermarkets and the higher variety associated with those supermarkets. There are other models out there, club stores, Wal-Mart, all these. They carry less variety on a category by category basis.

Yes, they are more efficient, but it's a different model. They don't have the variety. They can go to market in a different manner. The customer decides what's best. In terms -- I'm sorry, in terms of --

MR. BALTO: I'm sorry.

MR. SUSSMAN: In terms of small vendors, though, we have a very active diversity vendor program. Victor Thomas runs that and will be joining us tomorrow, and we're very committed to small vendors, both the minority owned and just small, and getting them started, giving them a helping hand because it's good business.

It's not only that we waive slotting fees, that's not enough. Most small vendors don't know how to do business with a big company. You have to hold their hand, get them started. We've had many successes over the years, of small companies that have gotten their start on our shelves one store at a time. We're very proud of that. There are ways for small vendors to get on our shelves, and we've showed the staff many examples of these.

MR. BALTO: Mr. Weber?

MR. WEBER: Win Weber. I could build an argument to suggest that slotting allowances actually could encourage the wrong variety. We've done several studies with retailers and found that if in fact slotting allowances are part of the bucket called buying income and the buyer or category manager has a certain buying income target, that to achieve those targets they may be more inclined to buy an item with a high slotting allowance or with slotting allowances to hit their targets to the exclusion of an item that would best serve the consumer.

So I think when we look at variety, we have to look at the fact that this can encourage the wrong variety to be purchased.

MS. DESANTI: Are you saying in essence that in your experience you have not seen that slotting allowances are a means by which to signal the product most likely to be successful, the most product most desired by consumers?

MR. WEBER: I do not believe slotting allowances signals one iota how the consumer is going to buy a product. You look at advertising, consumer promotion, the quality of the product, the uniqueness of the product, the category the product are in. There's a lot of factors to be considered. A slotting allowance does not signal whether or not that product is going to be successful in my opinion.

MR. BALTO: Scott?

MR. HANNAH: Scott Hannah of Pacific Valley. A follow up on the man from Virginia. It's a very interesting note about the local products down there. Picture a Washington potato, almost as good as an Idaho potato, and you create a totally fat free low calorie french fry, which is tested and ranks good. A local chain thinks it's great. They take it in.

Then the local chain is bought by a big regional chain out of Portland, and we're in trouble. We're warned we're in trouble. They're doing this systematic buying. Buyers are eliminated. The next thing that happens is that group is bought by a really big chain in Cincinnati, so you lose your local touch.

MR. UKROP: I would argue we shouldn't have those kind of people come to Virginia. (Laughter.) I think that's the difference with independents. Again we as a local independent, we buy from someone like we talked about earlier -- like Jay was talking earlier about his company -- and so we don't really deal a lot in slotting allowances.

It mostly comes through our wholesalers doing it. We do receive some but not at the magnitude of some others. But one of the things we think local independents are able to do is provide more variety. I don't know about all the Stop & Shop stores, but we work hard. That's one of our differentiating characteristics. It's the variety to not only give local people the opportunity to come and buy local or Virginia products, but at the same time -- I think the natural and organic product's a good example because there's so many of those coming in now and we buy through a different supplier, and there's really no slotting fees we know with regard to those products. There's no way those products will pay to be on the shelf, but we want to have them because the customers want them.

I do think on another subject that was mentioned earlier, the class of trade issue, I wish we could get those products that Costco has that are not available to us because manufacturers don't necessarily make us aware of those products.

We have to go ask for them. I think that slotting is just one piece of this puzzle, and you all put up an array of fees there. But there are a number of ways that the independent is really kind of odd man out in having things made available to him or her because of the so-called class of trade issue, which is another thing that's probably more important than the slotting.

MR. BALTO: Don Sussman, I see he wants to reply.

MR. SUSSMAN: Not to Bobby, but to something that was said before. First, I think there aren't any guarantees that because a product has a slotting fee, that it's going to be success. But even with slotting, many, many products have come to market, and I think the lower the buyer is to getting new items out the more bucks we would see, so I do believe that.

The second piece is there's no question that people can mismanage their business, manage for today and bring in items strictly to collect slotting fees but that's death over the long run.

Ultimately what we have to sell is satisfied customers, and if we clog our shelves with items that don't sell because we're taking the buck today, we won't be in business tomorrow, and the customers will tell us that.

MR. BALTO: I want to get a little more of the manufacturer's perspective and call on David Nickila, Peter De La Cruz, or Scott Hannah. Give us a feel for how slotting allowances are negotiated. The retailers have sort of painted a picture that they're willing to negotiate. Is that what really goes on in the real world?

MR. NICKILA: My name is Dave Nickila of Portland, Oregon. We're a relatively small bakery. We do about seven and a half million dollars a year. We started in 1995 so we're very young. The end of 1999 was the first time we came really involved with the slotting issues. We have major chains -- we have Wynnco, Safeway, Albertson's and Fred Myers -- and they're all owned by a lot of other big companies.

But we have four of them, and one of the suppliers came to us and told us that they're opening a new store so we have to give them two cases of every SKU that we have in the store. Okay? That amounted to $568. Well, this chain has 12 stores, and with this new store, there's no way we can recoup that amount of money in the first year of operation. They actually withdrew it from our account receivable account.

We confronted them on it. I had Margie, our gal in charge, give them a call, confronted them with that, that we can't handle that, we're not big enough to handle that. Basically we told them that our backs to the wall, we could give you $150 roughly in product to get going, and they sent us a check for $418.

We have a letter from another one of the chains saying that the two cases per SKU is going to be basically their policy and that we should develop a policy of our own if that's not acceptable, and it seems like this is coming about. It's affecting us, since we're relatively small.

Part of the reason I wanted to be here is the fact that we deal with a product to all the grocers here. We direct deliver it. We supply -- and there's quite a bit of cost involved in delivery. We guarantee it. We provide a reasonably good margin for them at 25 percent, and we try to build a business with service and quality, and this is the way we've operated, and now all of a sudden other factors are coming in.

There are other things. I don't want to belabor it, but I'm just saying that these slotting fees are a concern for us because we cannot afford to do this. There's an old adage, and I'm going to clean it up a little bit, is once you've prostituted yourself, it's pretty hard denying the fact that you're a prostitute. The fact is that we don't want to do that, we favor equal and equitable treatment for everybody we deal with. We don't want to favor this chain over here versus this chain over here, and unfortunately, we're kind of the only ones that still feel that way.

But what we've seen in our marketplace is that the independents, such as this gentleman right here, a small chain, are having a tougher and tougher time to survive, and they've always been kind of the ones to be leaders in innovations and so forth. We're having no ability to get into the grocer, to the buyers heart at all. We carry no clout. We carry no big wallet, so we are concerned, and I don't know how far this is going to go.

The grocers, I'm not here to knock them, they've cooperated and they've worked with us, but it's getting more and more difficult because we don't have that much to bring to the table for them.

So I think allowances are a concern to us. We provide promotional allowances. We want to run cents off and everything else, and a grocer will pass on a part of that, but at the same time we distribute in our marketplace all the chains except for one, the one that gave us the first slotting allowance. They discount. The rest of them up-price.

So if we're beginning with a 25 percent margin and they're up-pricing, they're making more than the 25 percent, and so consequently it's very difficult for us to try to find a vehicle to justify doing too much if our products are being up-priced. To me it's unfair to the consumer. The consumer is the one we're worried about in this conference. Savings are not necessarily passed on, and like I said, I don't see where slotting allowances in our industry are going to save the consumer any money.

MR. BALTO: Thank you, David. By the way tomorrow morning at 8:30 we'll be hearing from a number of other manufacturers who will raise concerns similar to David's. Peter De La Cruz?

MR. DE LA CRUZ: I don't know whether Scott wanted --

MR. HANNAH: What?

MR. BALTO: You're the one with the tent up.

MR. DE LA CRUZ: Sure. I put the tent up really in response to the question about how slotting fees might be differentiated from other promotional allowances. Certainly I think one distinguishing feature is that, usually from the manufacturer's perspective, I think for promotional allowances, they would have an ad or end of aisle display or something like this.

This statement isn't intended to disagree with the characterization that slotting allowances are not promotional allowances, but if you were trying through your question to determine whether they were promotional allowances, I think that might be a distinguishing feature.

MR. BALTO: We'll get to that question. Jay Campbell.

MR. CAMPBELL: You want me to respond to a question? I wanted to respond to several things, the gentleman down here, your consultant.

MR. WEBER: Yes.

MR. CAMPBELL: You made a statement that slotting allowances have never reduced price, et cetera, et cetera, et cetera, and people are going for the gusto and the bucks and all that.

I think the market somewhat dictates that, and I believe Ukrop said -- had quite honestly said that if you don't put up the right products at the retail shelf at the right price, then you're going to fail anyway, so if you go for those bucks and you don't put in this gentleman's bakery goods, you're not going to have the variety and selection the consumer seeks, so in effect the marketplace is going to control that.

And if there is a chain or if there's a regional competitor or a local independent who chooses to go for the bucks instead of going for what the consumer wants, he's going to fill ultimately, and I think that's the reality.

And your point from the standpoint that there are competitors that do not want to put your product in, that might be their mistake, and then I would seek out those who are willing to put your products in. Since you do direct store delivery you wouldn't do business necessarily with my company, but I can assure you the independents in our market would want the differentiation on their shelf, would want to have an item that is not a me-too item for them where they could differentiate from the big competitor out there who chose not to put your item in.

And I don't think it's all bad. In fact I think that's very good.

MR. NICKILA: I totally agree with you, the fact being though that the independents are getting fewer and fewer, and the consolidation of chains and everything else is getting pretty well established right now, so therefore it's very difficult for us to seek that market out.

MR. BALTO: Basically --

MR. CAMPBELL: Then let's bring up the issue of why there are becoming fewer and fewer independents, and that would shift the discussion to the slotting allowances that are offered, are the allowances in general that are offered, are they offered fairly to all competitors?

That is the bigger question as opposed to anything that we could talk about the rest of the afternoon. Is everything offered on a fair and equitable basis to all the competitors in the marketplace? And if they're not, then you are seeing preferential treatment paid, then you are fueling the fire for the bigs to get bigger and the smalls to disappear.

MR. BALTO: Mr. Campbell, what is your sense on that issue?

MR. CAMPBELL: The sense of that issue?

MR. BALTO: Yes.

MR. CAMPBELL: Is that we have a significant concern each and every day, that as a competitor in the marketplace, we want to be assured that we have the availability of every product that's out there, every packaging alternative on that product, the pricing, the promotion and the payment terms that are offered to each competitor on a fair and equitable basis.

If we receive that, we feel we can compete each and every day, and we won't worry about our retailers surviving in the future if that is done. If that is not done, and we're not receiving those products or the packaging or the pricing or the promotion or the payment terms, then we're ultimately destined to fail.

MR. BALTO: Okay. Let me go to an empirical question which anybody can provide information on. How large are slotting allowances typically, and how does this play into the question of how expensive it is to enter a market? Scott?

MR. HANNAH: Yes, Scott Hannah, Pacific Valley Foods. Slotting allowances are growing. I'll talk in terms of "per-store" because we talk about $50,000 or $10,000, you don't know how many stores you're talking about. So We'll talk one item per store or one SKU per store.

It used to be roughly like $25 on the West Coast, a little higher in Los Angeles but the volume was there. They're growing significantly. We're up to $75 to a hundred dollars in the West, and I've talked to fellows on the East Coast, and they say that's a bargain. It's up to $250 to $300 per store, so it's easy to do the math. If you have two items and a hundred stores, it's impossible.

As far as negotiating, that's a question. Are buyers willing to negotiate? They used to be, and they did negotiate somewhat, but lately they're not negotiating, and I'm not sure why. That's all I have to say.

MR. BALTO: Do you have some examples of where they're being demanded unilaterally without any form of negotiation?

MR. HANNAH: What is being told is they don't know your product. They barely know your product. This may not be the right answer that you're looking for, holler if it's not, but they don't know the type of media campaign you have. They don't know what type of trade promotion you're buying.

But the word is very clear. If you're not going to pay a hundred dollars a store for 100 stores, or a hundred thousand dollars, don't bother coming in. It's that pointed.

MS. DESANTI: Could I ask a follow-up question, Mr. Hannah?

MR. HANNAH: Sure.

MS. DESANTI: One of the participants earlier spoke about the possibility of smaller manufacturers getting in at a small level to begin with, a few stores at a time and then growing the market. In your experience is that a valid option, or are there problems with that?

MR. HANNAH: There are problems with that now, mainly because of the merger situation I mentioned. I'm not against mergers, don't get me wrong, but it's caused computer problems, logistics problems, where let's say you have separate warehouses in Seattle, Portland, Oregon, Spokane, et cetera, and you decide to make one massive warehouse in Oregon to cover the whole north Pacific.

So it's become very difficult to come up with a product to satisfy just a local need, and that's out of sympathy for the retailer because they're trying to achieve efficiencies.

MR. BALTO: Win Weber, is there something you would like to say about the amounts of slotting allowances and how that may translate to the cost of entry?

MR. WEBER: Well, I think that first of all we should sort of position this, that there are a broad range of behaviors in this industry, both on the retailer side as well as the manufacturer side. I sit and observe over a hundred buying or negotiation sessions a year purposely to stay on top of this.

And there are some retailers who are extremely disciplined in how they manage their businesses and manage their costs, as Stop & Shop has. There are other retailers who frankly are what I would call very unethical on how they back this business.

On the supplier side, there are some manufacturers -- and I think we should add the words consumer power here as well as just retailer power and manufacturer power. There are those suppliers that have very strong brands, high brand loyalty, who are very ethical. Any retailer knows when those suppliers walk in that the retailer across the street is getting exactly the same price. That's on one side.

On the other side, we will see retailers or suppliers frankly who are dealing in the deal of the day, and frankly the retailer is sitting there not knowing whether or not they're getting the same cost as the retailer across the street.

I had one of our retailer clients ask me some years ago, Win, how do I know if a supplier is giving me the best cost, the cost equal to the one across the street. I had to give him a lousy answer. I said, When the supplier says no, and very few suppliers will say no if they have great franchises.

Behaviors are driven on the supplier side in terms of whether they have strong brand loyalty or whether they're in commodity markets. If you're in commodity businesses and brands are substitutable, then negotiations may be a bit different. So there are a broad range of behaviors you see out here in the industry.

MR. BALTO: Let me just follow up with something. To what extent do retailers waive the allowances and give a break to smaller suppliers?

MR. WEBER: It's interesting. As Bobby said we work with a number of regional chains, and they have a tendency to actually be more sympathetic to the smaller suppliers. I think it's because they themselves grew and had to work their way up, and so I see this type of behavior across more than just one or two.

MR. UKROP: I would argue the same thing takes place with customers, not just the retailer's suppliers. It's all built in trust and relationships, so that those of us that are perhaps closer to our customers by virtue of being smaller and maybe in a region or locale, there's a connection. There's an increasing connection with these people, and it could be your neighbor that's bringing in the product or a guy or gal that's just starting up a new business and you're trying to help them get going, and you try it, but you put an amount out there, there's no way.

What we know is if it's successful there's a good chance the competitors will put it in there. Our competitors won't put it in until they see it sell at our store. Those people will get shamed into putting in those products, but I think that happens a lot of times. I think that has to do with the fact that when the big get bigger, they don't have time, they tend to not be as attentive.

But they don't have time because most often they're driven by shareholder value where smaller independents are pretty much private companies. And so they're more interested in taking care of their customers and associates than the shareholders. So that gets back to this: How people treat people, and it's a golden rule in a way.

MR. BALTO: Let me turn to Don Sussman and pick up on a question that Susan asked before. Is it possible for a small manufacturer to sort of enter incrementally perhaps by having its products just shown at just a small number of stores, and then based on slotting allowances for that limited number of stores and that limited display, building a success record, and then being able to enter chain-wide without as great a need for slotting allowances?

MR. SUSSMAN: Absolutely. At Stop & Shop we have many examples of this. I'll give you one -- a company called Lebonal Canola Oil, based out of Connecticut and who started about ten years ago. A couple who actually immigrated from Portugal made this stuff in the garage and delivered it to ten Stop & Shop stores. They soon outsourced it to somebody else who packaged the product for them with their formula, and they put it into our wholesaler, our specialty wholesaler, it's now in distribution at 204 Stop & Shops as well as four or five other major companies serviced by the same wholesaler.

We're proud of those examples. There are many obviously in this scheme at Stop & Shop, since we do about $7 billion a year. They're relatively small to the total, but there are many in there, and we have an organized program to increase then.

MR. BALTO: Let me also ask you, Don, you said earlier that slotting allowances are used sort of like as a general revenue stream to just basically improve the stores.

So if we walked into a retailer that used slotting allowances and another retailer who didn't really use slotting allowances, what differences would we see?

MR. SUSSMAN: Quite honestly I couldn't tell you that. I can tell you about my stores.

Once an item is put on the shelf, it's got to make it on its own, however it got there. When a vendor pays to put a new item on the shelf and gives a slotting, we feel we owe six months, and at the end of six months we sit down and review the history, and if it's accomplished its initial objectives, it's there forever until something else comes along to displace it, so we don't assign shelf position by slotting.

That's just part of the accept or reject discussion. We have a buying committee. Lack of slotting fees does not eliminate an item, and having slotting fees does not guarantee acceptance of an item. It is part of the equation.

MR. BALTO: That six-month period of time, by the way, for any of the retailers or the consultants: Is that the normal period of time, or do people have longer periods of time to require slotting allowances? Win?

MR. WEBER: In terms of how long you're going to watch a product?

MR. BALTO: What's the period of time you're acquiring it for?

MR. WEBER: Well, usually you see it in the initial shipments. You don't see the slotting allowances continuing for an extended period of time. That's my observation. Don, I don't know.

MR. SUSSMAN: Sorry. I misunderstood. It's a one-time payment, but we guarantee the manufacturer at least six months to establish the movement, and we won't review it until it's had a good chance for six months to establish its movement within the category.

MR. BALTO: Let me return to Bart Weitz.

MR. WEITZ: I'm Bart Weitz of the University of Florida. I have a professorial comment and hypothesis. I think one of the things that appears to be happening or has been happening over the last 10 or 15 years is that there is a huge drive towards greater efficiency in the supermarket industry. A lot of that was initially brought up by the development of alternatives to buying groceries in supermarkets, such as Costco or Wal-Mart.

And part of that drive towards efficiency is to be much more careful about the items that are stocked and to try to use some of the methods that Mr. Weber probably consults with to sort of track the cost of individual items, the total cost of that item and allocate overhead appropriately and so on.

So what eventually happens is that, as you were saying about Costco, you know how much your end product costs or total costs are when you look at each of your products, and then you can figure out which ones you want to put on the shelves and which ones you don't.

So I think what is happening is is that the supermarkets are driving towards efficiency. That leads them to also consolidate to some extent too, and what enables them to do that is sort of this increase in technology and communication systems that provide you with the information to be able to do that.

Now the question is, what happens if you sort of look at the competitive dynamics? What will happen is that there will be opportunities that will come up where people that aren't being driven by these terrific efficiencies and want to have more variety will start up supermarket chains or manage their supermarket chains that have more variety, perhaps Ukrop's or something like that.

So you'll have a choice. You can either buy at Wal-Mart at a lower price and have less assortment, or go to Ukrop's and have more assortment and perhaps pay higher prices because they have higher price with more assortment.

I think it's very difficult to sort of manage that competitive dynamics from a government's point of view. The consumer's going to figure out how that plays out, and if they don't want variety, if a consumer doesn't want variety or as much variety as they have had in the past, then supermarkets are going to respond by providing at a with lower cost with less variety.

MR. BALTO: Let me just mention that the

government only intervenes where there's true market failure and that the market doesn't effectively function.

Let me turn to John Eagan because Bart's comments sort of struck me as a question. John, can you explain to us a little more why it is that Costco doesn't use slotting and is sort of aiming for the lowest wholesale price?

MR. EAGAN: Well, our objective is to get the lowest net landed cost so that we can offer our members, the customers, the lowest possible price for the value that they're receiving. We view things like slotting allowances as an increase in cost that the consumer ultimately pays for, and I don't want to pay for the slotting allowances that Stop & Shop have or Safeway.

I don't want the manufacturer's cost spread out over all their customers. We try to get down to the menu pricing so we can take that part out of the equation, so we don't pay for slotting allowance that was paid for a Ralph's or a Safeway or someone like that as part of their overall cost of goods.

MR. BALTO: I want to turn to the issue of managing risks and try to get some of our academics in, Professor Gundlach, Professor Rao and Mary Sullivan. Would one of you want to sort of phrase the managing-risk argument, and perhaps Professor Rao can talk about the degree that his research has sort of focused on that issue and supported it or found it lacking. Greg?

MR. GUNDLACH: The risk argument is basically that the proliferation of new products brought about considerable risk on the part of retailers who have to manage that risk in terms of the acceptance or denial of a product in the marketplace.

The source of the innovation at the same time is the manufacturer, and, since the retailer then incurs that risk, slotting fees allowances are the basis and mechanism used to shift that risk back to the source of innovation.

You can look at the number of products that have entered the marketplace and track them over several decades. The latest reports here are that the number of new products offered to the trade exceed 23 to 24,000 at present, where only ten years ago the number of products in the trade were approximately in the vicinity of 12 to 15,000.

So there are a number of new products and not all of them being able to fit on the shelves enhances that risk.

MR. BALTO: I probably should have actually started with Don Sussman and Jay Campbell and Bobby Ukrop. Is that a significant reason why you request slotting allowances?

MR. SUSSMAN: Absolutely.

MR. BALTO: How do you see it from your perspective?

MR. SUSSMAN: Well, I think I'm plowing over ground I went over, but basically there's a risk in terms that a new item will fail, and we're going to wind up with both inventory and cost in our system for items that have not brought new customers to the category or have not increased our sales.

There's a risk that we're going to give up the income stream for items that we're selling and that we've discontinued, and the third risk is again disappointed customers. Even a slow moving item has customers who choose it over the assortment of competitive items, and when we discontinue that item to bring on a new item, there are going customers who are going to be disappointed. Those are all risks as we see them.

MR. BALTO: Professor Rao and Mary Sullivan?

MR. RAO: Mary, you want to go first?

MS. SULLIVAN: Well, I just have a quick question. I think the theory of the managing risk is a theory that slotting allowances are efficient, and the theory assumes that somehow the manufacturer's better able to bear this risk than the retailer, and if that's true, then shifting the risk is efficient.

So I just have a question rather than a comment. Why would the manufacturer be in a better position to deal with this risk? An explanation for why the retailer might be in a better position to understand and deal with the risk is that the retailer sells many different products in a given category and might be better able to evaluate what is going to sell in this store, in this location and so on. That was a question.

MR. BALTO: Does anyone want to answer Mary's question?

MR. SUSSMAN: I would be happy to. If you look at Stop & Shop in the grocery side of our business, we probably have between nine and ten buyer category managers managing 15,000 SKUs. They do a pretty good job of managing the information flows and the product as we see them, but we don't know enough about every category and every item.

We depend on our manufacturers to do a lot of the basic store research for us, and manufacturers are driven by many things, one of which is just to get increased shelf space and to grow their market shares. That's their jobs.

So if they can displace a competitor's item with one of their own, even if their item sells less than their competitor's item, they've won. That's what their motivation is, and so we kind of depend on the manufacturers to help us understand what customers want in a category.

Yeah, we have our own opinions, but we can't rely on our own judgment. There's too few of us and we have a lot of work to do, and with so many new items coming out we really do feel that the manufacturer has to manage this for us.

MR. BALTO: By the way we will get into the specific issue in more detail in the category management panel right after lunch tomorrow. Akshay?

MR. RAO: The issue of risk sharing is kind of interesting. I think the answer lies in between, and to continue on Bart's comment, this is going to be very professorial in the sense that I'm not going to take a position.

I actually have some data on the topic, and it turns out that there are some circumstances in which manufacturers know more than retailers and there are other circumstances in which retailers know more than manufacturers. Depending on the degree of information asymmetry between the two, depending on who knows more, there is a tussle about information.

And if the product is likely to not fail in the judgment of the retailer, there is a likelihood that it will succeed, that's where the negotiation starts, and if the retailer knows more than the manufacturer does about the likely success of the manufacture, then the manufacturer winds up paying a higher slotting fee, so ultimately it is a contingency. It is an interaction over the likely success of the new product.

If the product is likely to fail, then the conversation does not even begin. No amount of slotting allowance will get you into the shelf if the retailer does not believe it's going to succeed. But should the retailer privately come to believe that the product -- be it flashing lights on diapers that are wet -- that it's likely to succeed, and the manufacturer does not have the market and research information to support the likely success of the product, then the retailer, quote, unquote, extracts a relatively high slotting allowance from the manufacturer.

So I'm not exactly sure whether that speaks to your question, but it's been weighing on my mind for the last 24 hours, and I had to get it off my chest.

MR. BALTO: By the way, Professor Rao and one of his colleagues a have recently published paper. They did empirical research that actually looked at this issue, and it's a very interesting paper.

Let me turn to John Eagan. We've heard why grocery store retailers need slotting allowances to deal with risk. Why isn't that a problem at Costco?

MR. EAGAN: We look at the event of selling product to the consumer. The manufacturer does their portion. We do our portion, and it's a continuum that goes from development of the item all the way through and to the end user. When the manufacturer does their part and I do my part, it gets accomplished.

It's a different business in the club industry because of the volume that we run. We don't really run into big risks of a lot of inventory around. We can flush goods out pretty quick. Our biggest concern would be if we asked a manufacturer to come up with labeling. Getting rid of packaging for them would be a bigger risk than finished goods because the goods move so quickly, and it isn't around a long time, and we can do it by price, by reducing the price to get rid of it, or other ways.

I mean, if the manufacturer wants to share in that, that's fine. We will accept that, and we'll drop the price accordingly to help blow it out, but we don't have warehouses where we have this inventory stocked in, so it's not an issue as it would be with a wholesaler or a retailer.

MR. BALTO: Don, did you want to reply to that?

MR. SUSSMAN: I think everything you said is true, but I also think that we have more store brands on the supermarket shelves than in club stores, and club stores have a limited assortment. They tend to choose the proven items, not that we always jump on new items, but when you have a limited assortment you have to make sure everything you carry is a winner.

MR. BALTO: Right. Let me ask as long as we're dealing with the risk issue, are there less restrictive ways dealing with the risk issues such as a failure fee? Scott, if you wanted to speak to the earlier issue, that's fine.

MR. HANNAH: This risk?

MR. BALTO: Yes.

MR. HANNAH: Not the same thing. It's tied together with failure fee, but I'll give you a true case scenario, which I think means more than anything. About five or six years ago we came out with a very deluxe petite frozen vegetable that was microwavable in a poly bag, came out perfect, delicious, et cetera.

It was not tested. We're a small company. Chain store buyer says, How do I know this will sell? Well, the offering of $50,000 wouldn't make it sell, you see, so together we decided let's take five stores as a test group. The buyer said, if you can increase my profits over a six-week period versus the same control group, you're in. I think that to me is an excellent approach of risk, and by God, it worked. I was a little spooked with that kind of test but it worked.

Another thing about risk that you were saying is there is a risk, but the retailer has to share the risk. We're all in the food business together, so this mystifies me just a little bit. You have slow-moving fees and we have discontinuance fees. If we had an item that was slow moving and the buyer said, You either add a slow moving fee or get this item up to a hundred cases a week, I would find out why that item wasn't moving and would make it move, discontinue it, or pay the fee. So that's another approach.

MR. BALTO: So, Scott, what are the possible alternatives to a slotting fee that could sort of deal with the retailer's concern that at the end of the day they're going to have a lot of unsalable goods that they've got to get rid of that they've ultimately paid for?

MR. HANNAH: Well, I talked to another gentleman from the midwest during break, and he said the same thing. Some of these things you take for granted, but a lot of companies guarantee their products. They won't guarantee that they'll sell at a specific rate, but if they don't sell or meet certain objectives you go pick them up.

In other words, a buyer does not have a risk of having to close these out and take a loss. Our brokers, our sales agents or whatever just go around and pick these darn products up and get them out of there, give our apologies. I know there's other costs associated with that, but that's one way to do it, and another is a discontinuance fee or a warning of a slow-moving fee.

MR. BALTO: Okay. Bob Houck?

MR. HOUCK: I have one observation that just occurred to me and then one alternative way of dealing with slotting allowances.

One involves some other industries. This is somewhat along the lines of a discontinuance fee or a slow moving fee or whatever, I've never heard of that one before. In some other industries what is typically done with introductions of new products is generous mark-down allowances. When you're selling in the new product you offer high mark down allowances or -- and maybe this isn't practical in the grocery industry -- but typically again in other industries they will offer very generous return policies. Simply they're guaranteeing the product. If it doesn't sell, return it to us and we'll take it back. So that's one of the ways it's done.

Alternatively, one of the things that some manufacturers will do, who would prefer not to do mark-down allowances, is that they'll offer very generous scan-down programs for their new product introduction. Scan-down is where they pay so much per unit on what is sold out based on scanner data from I. I. Nielsen or something like that. Some will offer incremental scan down allowances -- if you sell above a certain unit volume, it will increase the amount per unit that we offer. And that is a kind of guarantee to the retailers that if they get behind a product and promote it, they will be rewarded very generously.

MS. DESANTI: In your experience how frequently do you see these different types of practices that you've just described being used? Are those frequently used, not very frequently used, and if so do you have any observations about what problems might be associated with using those alternatives?

MR. HOUCK: Well, the sort of things I was talking about in terms of mark-down allowance and return polices and everything, that is really outside the grocery industry. That is more in other categories of retail. The scan-downs, that is a grocery thing or grocery and drug, and it's done a lot. It isn't done that much with new product things, but it is done occasionally there, and it was just something that occurs to me, as where I've seen it used it does seem to be effective.

MR. WEBER: I have some thoughts.

MR. BALTO: First Professor Rao.

MR. RAO: Just a comment on the failure fee versus slotting allowance issue. If you accept the notion that slotting allowances signal, and I suspect despite my data that there is some truth to that argument, that if a manufacturer walks in to a retailer and says, Here's a million bucks and a bottle of beer with a pickle in it, it will actually sell well. It probably does communicate something, much like a failure fee does.

A failure fee is essentially a warranty, so if you take that analogy and apply it to our world, when you purchase clothing from Lands End and are given a lifetime warranty, some people abuse it. By the same token, some retailers could abuse the warranty and the failure fee, and as a consequence the failure fee fails to signal.

However, the slotting allowance does not fail to signal, so all other things being equal, they will both signal, but the likelihood that the failure fee will fail to signal is higher because of potential abuse. It also is advantageous to a manufacturer because if you have a good product you never have to pay the failure fee. It's much like not having to fulfill a warranty on a good product.

So that's all I have to say.

MR. WEBER: I just have a couple thoughts. The cost of failure is quite high both to the retailer as well as the manufacturer. There's no winner in failure. On the manufacturer's side just about every retailer today asks for guaranteed sale. Forget slotting allowances, forget failure fees for a second. Just about everyone asks for guaranteed sale, and there's a point in time, let's say in six months, if an item isn't selling, a retailer is going to tell the manufacturer to ship back the goods from the warehouse.

And now we've moved product in the reverse direction in the distribution system, which it wasn't built for, and there are tremendous costs there. The supplier owns tremendous inventory that they're going to throw in the ocean or whatever, at tremendous cost, depending on what they spent on advertising and they didn't sell the product through.

The retailer has cost, product left on the shelf. It's either marked down or sold through. Seldom do the manufacturers pick up it off shelf. There's a tremendous cost here.

To start talking about slotting allowances and failure fees, when we look at the cost structure of every retailer, the movement of product through the distribution chain, the cost is different for every retailer. They all have different areas of efficiency and inefficiency, and I think to try to tailor some type of formula, structure for slotting allowances or failure fees, I think it would be virtually impossible because of the financial dynamics of retailing and suppliers today.

I think what we're looking at is to make sure the retailer knows, and the supplier knows, that if the retailer is charging slotting, at least some suppliers today will just shift money from promotional dollars over to slotting allowances.

The bottom line is the supplier has not spent one more dollar, but if the retailer wants a slotting allowance, give him a slotting allowance, fine. They'll just take it away from promotion, display, and that's happening today. There's a perception that certain retailers are making more money with their slotting allowances. I can argue with many of the major suppliers today that the retailer is not getting one dime more. We're just moving stuff from bucket to bucket.

MR. BALTO: Let me follow up on that. Mr. Weber, should we look at that as being an innocuous practice, that money is going from other promotional funds into slotting allowances, or is that an inefficient practice because other promotional practices may be more efficient at increasing demand?

MR. WEBER: Well, the most inefficient spend for a supplier in a category that's a non-expandable consumption category, the most inefficient spend is trade promotion dollars because trade promotion dollars do not build brand equity. Trade promotion dollars drive price and share but they do not build category consumption and brand equity.

As a percent of sales, trade promotion dollars have became increasing since 1970s at the expense of being able to spend in advertising in a marketplace where advertising is much more segmented today. So if the suppliers are trying to build brand equity, trying to drive their cost structure within reason in trade promotion, they're trying to move most of their dollars toward feature prices or toward display and trying to keep as little as possible from not working toward the consumer.

So the larger suppliers today who are working with market development funds are just putting slotting into the menu and saying, Fine, it's the retailer that wants to earn the money that way and it's performance is defined as slotting allowances, just like performance may be defined as feature prices, fine, and that's where the industry is heading.

MR. BALTO: I understand that these things may be equivalent in some perspective. Should they be equivalent from the perspective of consumers? Are consumers better if the money is spent in one pot rather than another pot?

MR. WEBER: I really don't know.

MR. BALTO: Mary Sullivan first.

MS. SULLIVAN: I would like to go back to failure fees for just a moment. I just heard a couple of good reasons why you might want to pay a slotting fee rather than charge a failure fee after the fact. One is that if slotting serves some sort of signaling role, you would actually be more likely to choose a good product with a slotting fee.

The second is that there are failure costs that you might be able to prevent if you could just stop a bad product from being introduced, but ignoring those two reasons for now, I can think of another reason why a failure fee is less efficient, and it just seems to me that it might be harder after the fact to charge a failure fee than it would be to charge a slotting allowance up front, especially when the manufacturer wants to get the product on the shelves.

And there might be genuine disagreements about what constitutes failure. There are also occasions in which a manufacturer may go out of business in which he simply can't collect the fee.

MR. BALTO: Jay Campbell?

MR. CAMPBELL: All of the things that have just recently been discussed in the last 20 minutes or so to me are very innovative and creative ways of doing business in the American marketplace. And I think that whether you call it a presentation fee, a slotting fee, a display, a pay to stay or failure fee, these are all creative ways that people do business. Now, whether they're right or wrong is not relevant. It's still going to impact someone's profitability whether they're at the manufacturer level, distribution level or retail level.

The real concern from a governmental standpoint should be is are these things disclosed by the manufacturer to all the competitors in the marketplace. If they are not, then you have a problem, and also if they are not fairly and equitably distributed in the marketplace in that fashion through marketing development funds or any other buckets that are out there. Are the buckets created on a fair and equitable basis to all competitors? That should be our concern.

Whether we come up with a whole new fee structure or new allowance structure or anything like that, and it's real creative and real cutesy, shouldn't be our concern. Our concern should be: Is it offered equitably, fairly and disclosed by the manufacturer to all the competitors in the marketplace?

MR. BALTO: Greg?

MR. GUNDLACH: I want to go back to the discussion of risk, just from the standpoint of how failure fees might relate. But before that, I think there's a couple observations that could add to the discussion here.

The type of risk that we're dealing with is approximately 80 to 90 percent. It is upwards 20,000 items that are offered in the trade and that actually fail each year, so in my mind the level of risk needs to be looked at.

What is driving that risk? If you look closely at it, many people believe it's the lack of development of novel and truly innovative products in the marketplace, and many categories being at the mature level and offering only brand extensions, line extensions and things of that nature.

So we want to address risk. I think we need to get back to understand where the risk is coming from and the nature of that risk.

Another point to add to the discussion is that really the management of that risk has to be addressed from both perspectives. While the source of innovation is the manufacturer, once that product is in the retailer's hands, the retailer has also something to do with the success of that product, so untangling where and whose failure it is becomes a difficult issue.

I think those two issues overlay a lot of the discussion.

MR. BALTO: Steve Salop has joined us. By the way, to wet your whistle for tonight's reception, Steve will be making a separate presentation to us at the end of this panel. It's actually a transition device to our panel on exclusivity. Steve will share some thoughts about how we should look at exclusivity in this setting. Steve?

MR. SALOP: Actually I thought I was proposing a toast to slotting fees. I wanted raise a somewhat broader view of risk, and it has occurred to me that perhaps we should think about slotting fees and the growth of slotting fees as redefining the retailer business model towards something -- moving away from retailers earning profits from marking up the wholesale price of the products they stock to one in which they rent the shelf space and give the manufacturer greater control over the shelf space and let the manufacturer bear the risk that the products they put on the shelf, and the way in which the products are placed and the pricing of the products doesn't make economic sense.

So it's something I wanted to raise to the group. In that regard, I read an article recently in which PepsiCo said that what they wanted do was put their thirst-inducing salty snacks on the shelves next to their thirst-quenching soft drinks, and they were hoping to convince retailers to do that.

And it occurred to me that, well, why couldn't Pepsi just rent some shelf space in order to try out that concept, let them bear the risk that it would be a good idea versus not a good idea.

MR. BALTO: Let me turn to Scott Hannah.

MR. HANNAH: I've heard before of this "bucket of money" approach, where if you don't or can't pay a certain slotting allowance, just offer so much for displays in the store, trade advertising, whatnot, and let the retailer take that money and apply it toward slotting allowances if it wants. Correct me if I'm wrong, that's what I think I heard.

What you're doing as a manufacturer is shooting yourself in the foot. In other words, we buy these displays, end displays I'm talking about, separate displays to increase the sales like six to seven times during that period. The idea is to get awareness to the consumer. If we cut those down to one display or two displays for the year and apply that money in slotting allowance, I don't see where the gain is. I don't understand that type of thinking at all.

As far as a failure fee, if you have other products in the store -- I can see what the lady was getting to, if you have other products in the store failure fee is not a problem because the buyer can say, Hey, look, you promised to pay a failure fee and you owe this failure fee. You're still shipping us six other items of this other brand. If you want to keep that in there or not have it deducted from your invoice, you pay this failure fee like you promised.

But if you go in with five items and you have no other items in the store and you fail, that could be a problem. It could be a bookkeeping nightmare to put up an escrow account or something. But the point is the slotting allowances up front take away from the very thing you're trying to do, and that's promote the product, advertise a product. That's the bottom line.

MR. BALTO: Don Sussman?

MR. SUSSMAN: Ultimately what we're after is satisfied customer sales and profits, and it's the retailers and the manufacturers who do that best that are going to be successful. It's for the market to decide who's doing that best, and for the customers that's essential.

MR. BALTO: Bart Weitz?

MR. WEITZ: I just wanted to respond to Dr. Rao's point about changing the model of retailers. It seems that if that's your vision, then basically the value that retailers add to the equation is lost. One of the values that they add is to provide an assortment that their customers want, and what you're doing is saying, I'm just going to let manufacturers bid up and buy this space, and therefore now I'm sort of not providing this value of providing a tailored assortment, I'm leaving it up to the manufacturers just to do that.

It seems to me that gets back to the point that Mr. Sussman mentioned. Slotting allowances aren't the only thing that determines whether they put something or the shelf, because the retailer is serving the consumer by weeding out these products where a manufacturer says, Well, I'll just do anything I can to get this on the shelf even though I know it's a bad product.

MR. BALTO: Jay Campbell?

MR. CAMPBELL: Isn't that the beauty of the marketplace? Some people make stupid decisions and some people make great decisions. If you want to sell your shelves out to a manufacturer, then let them and hope they're my competitor because then my retailers will be very, very successful.

MR. BALTO: I want to go back to the issue of cost just for a chance for some additional observations by either the consultants or the retailers or anybody else. To what extent do slotting allowances approximate the actual cost of new product introductions. Any observations?

Professor Rao.

MR. RAO: My data suggests that folks with lower costs, retailers with lower costs, actually get larger slotting allowances. This I can only explain by speculating that they're larger, more powerful, so their unit costs are lower and they are able to extract higher slotting allowances.

MR. BALTO: Professor Rao, did you look at the size of the retailers in their individual markets, that being a potential factor?

MR. RAO: Yes, the sample of retailers that I'm looking at is homogenous in terms of size. There's a nice classification amongst the people who do receive slotting allowances and those who don't in terms of size, and then when you look at the folks who do receive slotting allowances, they're relatively homogenous so there isn't that much variation, hence the speculation.

MR. BALTO: Mary Sullivan?

MS. SULLIVAN: Just a clarifying question. Did your study include in its measure of cost the opportunity cost of foregone profits from the discontinued product?

MR. RAO: Right. We had three measures of cost. I'm going to try to recall. One was the opportunity cost. One was the cost of shelving. And one was the cost of data management related to the new product introduction.

MR. BALTO: Another invitation to the--

MR. SALOP: Can I ask a question?

MR. BALTO: Yes.

MR. SALOP: One would think that the lower cost stores would have higher market shares so that the higher slotting fee could be corresponding to the higher market share. So did you control for the higher -- for market share in this?

MR. RAO: No. I had a measure of retailer power relative to other retailers, whether they were more powerful or less powerful, and on that they did not differ, but I did have a measurement.

MR. UKROP: Bobby Ukrop, I would like to ask how you define powerful.

MR. RAO: Powerful in the sense of retailer power?

MR. UKROP: Yes.

MR. RAO: Whether they considered themselves to be more powerful than their competitors.

MR. HOUCK: How large were these companies?

MR. RAO: They didn't tell me. It's kind of difficult to get information about slotting allowances from retailers, as you can imagine. They do not want to reveal more than they really have to.

MR. UKROP: I was just wondering, do we know whether or not the public companies that continually -- the consolidators -- are those people kind of driving this increase or the use --

MR. RAO: Do not know and cannot tell from my data.

MR. BALTO: One more invitation to the supermarket folks or the consultants to talk about how slotting allowances are used, the degree they're related to costs. Don Sussman.

MR. SUSSMAN: I would just say if you're asking whether the real cost we do have with bringing in new products and discontinuing old are greater than our slotting fees or less than that, our slotting allowances more than cover expenses, if that's the question.

I want to make a point that though it sounds like we're against new items, just the opposite. New items are really are the life blood of industry. Even though most new items fail, they do provide a lot of buying power and stimulation to the customers.

So we're very much in favor of new items, and we bring on new items and try to give them every chance to try to succeed so it's not at all that we don't like new items to come forward.

MR. BALTO: Bart Weitz?

MR. WEITZ: If I understand the efficiency argument correctly, it isn't that the slotting fee should cover costs, they should cover risks. The costs to introduce an item might be very similar across items, except maybe for these size problems and things like that, but the idea is that the risk would be different and you would charge a higher fee when there was a bigger risk under that theoretical argument.

MR. BALTO: Can I ask people, would you expect, based on risk assumption or whatever pro-competitive rationale one ascribes to, would you assume because of that that you would see that slotting allowances differ by product or that they would be the same?

MR. SUSSMAN: Different by category, absolutely.

MR. WEBER: Win Weber. I don't even know how you could define risk. I could argue that a supplier going into the marketplace with sampling, heavy advertising, driving awareness, initial trial, the risk there could be a lot different than the supplier who's coming in and just putting a product on the shelf with a slotting allowance hoping it's going to sell.

So there's so many components in this issue of risk definition. It goes well beyond costs in my judgment.

MR. BALTO: Don Sussman.

MR. SUSSMAN: Well, I can tell you -- I can give you an example of risk. Our dairy cases, we just can't build them big enough. Everything in the dairy case moves. It's a growing part of the business. Items that we discontinue out of our dairy case would be winners on the dry part of our business, so to take any item out of our dairy case, we have items that are being discontinued that average two or three cases per week per store. Those would be big successes in any other categories.

To discontinue one of those items that's a big risk for us, so, yes, we would look for higher slotting fees in the dairy category for that reason.

MR. BALTO: Are slotting allowances paid for preferential shelf space? What's the experience of the panel?

MR. WEBER: Win Weber. I have not seen evidence of slotting allowances in preferential shelf space.

MR. BALTO: Anybody else?

MR. HOUCK: Two things. One is there are allowances that might pay for preferential shelf space, but that wouldn't be a slotting allowance. That would be a display allowance of some type. There are allowances being paid but it's not a slotting allowance.

I also wanted to go back to something Win said. He was talking about how there is greater risk if the manufacturer isn't doing sampling and promoting and such. Therefore, you would have to pay a higher slotting allowances.

And that's exactly what we've talked about to some extent. In some cases manufacturers are moving some of their money from promotional funds to slotting allowances. If they moved it back to promotional funds they might not need as much in slotting allowances.

MR. BALTO: Are slotting allowances charged for existing products? Are there pay to stay fees? Anyone on the panel? Nobody knows of any instances of pay to stay fees?

MR. WEBER: I have not seen evidence of pay to stay fees, so that's an answer.

MR. BALTO: Scott Hannah.

MR. HANNAH: You can't name names, but no. I heard one of my brokers out of the midwest recently said that a wholesaler, no one here I don't think, is charging a pay to stay fee.

MR. BALTO: For what types of goods?

MR. HANNAH: It's in the frozen food category. And these items are not in the bottom. They're like in part of the bottom third, so I'm not sure what's going on there.

MR. BALTO: I take it that Associated, Ukrop and

Ahold don't charge pay to stay fees?

MR. SUSSMAN: That's correct, Stop & Shop and Ahold do not.

MR. CAMPBELL: However, if they were offered to a competitor in our marketplace, then I would expect them to be offered to me.

MR. WEBER: Let's redefine this just for a second, and that is if you're in a category where there is low or no brand loyalty, whereby the retailer has much greater negotiation power because you do not have consumer power on the pull side, then you have the issue of substitutability and an item or a brand on a shelf, possibly the retailer will say, You're going to have to lower your costs or pay me promotional allowances to stay.

I don't view that as pay to stay, but that's a reality in commodity businesses in terms of substitutability, so I think we should look at it that way as opposed to pay to stay.

MR. RAO: Can I ask a question about that? Why would they do that? Is there some other product knocking on their door coming in that would make them more money?

MR. WEBER: Yes.

MR. RAO: In the commodity business?

MR. WEBER: Yes.

MR. BALTO: Professor Salop?

MR. SALOP: I guess I don't know whether I'm confused or surprised by this conversation. If I think about various brands where there's a strong number 1, and then there are a number of other brands competing to be number 2, and I could certainly imagine, I have seen situations where the supermarket only carries two brands and different supermarkets in the city carry different, so they all carry the strong number 1, but then they vary in the number 2 brand they carry.

And are you saying that supermarket chains do not go to the manufacturers and say -- no, to the 2, 3 and 4, the people who want to be the number 2 and say, Look, we're going to carry the number 1 and we're going to carry one other brand and we want to hear the package that you'll give us if you want to be the number 2. You're saying that doesn't occur at your chains?

MR. SUSSMAN: No. No, you're talking about slotting fees. After an item has been there a year, we go back and say, Hey, if you want to stay for year two, you have to pay again. That's what we consider slotting fees, absolutely.

If an item is under attack, we'll look at the item and say, We're going to discontinue you unless you have a better product coming out and give us a better package, and they can respond with lower cost, higher promotions, absolutely. That's an ongoing negotiation. They have to fight it out on our shelves, but it's not a slotting fee issue per se. It's a total package, sales, profits, customer satisfaction.

MR. SALOP: Fine. Okay.

MR. BALTO: It's time for our first ultimate question? What's the impact on consumers? Anybody here can contribute. What's the impact of consumers in terms of price? You can repeat things you've said before. Scott?

MR. HANNAH: Sorry for the repeat because I think I spoke at first about this, but it can't help but increase prices to the consumer. I don't see how not. It's a very, very expensive item. I did a little quick math showing this item introduced in Seattle, Washington. For a product with four items, you would spend $200,000 on slotting allowances, 150 on media advertising, about a hundred thousand dollars on trade promotions. Where is that $200,000 going to go? You have to raise your price. It's simple math.

MR. BALTO: Bob Houck?

MR. HOUCK: I really don't have any thoughts on it. To me it seems like a wash. It's all different funds.

MR. BALTO: Okay. Don Sussman.

MR. SUSSMAN: I do the math differently. We've got a bottom line to make. We have a return on our assets to make. All forms of payment help us keep our prices down to the customer. If those payments stop, we either have to raise prices or make less money. The manufacturer will have more money. What they do with that money has no guarantees.

MR. BALTO: Professor Weitz?

MR. WEITZ: It's my impression there are studies that have been done that have looked at this shifting market power from manufacturers to retailers which is supposedly one of the bases for this use of slotting allowances. Most of those studies show that actually who benefits is the consumer, and that the costs get lowered, the retailers don't make more profit, the manufacturers don't make more profit, but that the prices that consumers have been paying for supermarket items has actually been going down.

MR. WEBER: I do not believe that that is the result of slotting allowances. That is the result of a giant competitor with supercenters that in fact is setting the market pricing in core categories, and it's changed the competitive landscape throughout the United

States.

MR. WEITZ: I guess my point was is that you brought up this factor that there have been slotting allowances for 20 years, and for 20 years the amount that people are paying in supermarkets is actually not going up, and so it doesn't seem to have a negative effect on pricing.

MR. BALTO: Mary Sullivan?

MS. SULLIVAN: Just as a matter of theory, if slotting allowances serve some sort of efficient role, if they have an efficiency associated with them, then maybe a manufacturer's costs really are going up a couple hundred thousands, but maybe somebody else's cost are going down more than a couple hundred thousand dollars somewhere else in the system.

So ultimately you could have this thing that looks like a cost increase actually resulting in lower prices ultimately for consumers, although that's just a theoretical point. I really don't know anything about it.

MR. BALTO: Okay. Next part of the question -- by the way, I should add we here at the FTC spend a considerable amount of time looking at supermarket merger enforcement, and part of the reason why is because it's a very competitive industry that we want to make sure stays very competitive.

What about the impact not only on price but the impact on consumer choice, on product diversity, in the development of new products and innovation? Any comments on the impact of slotting allowances in that area?

MR. CAMPBELL: I think it's somewhat unrelated to slotting allowances itself. It's more related to the publicly held business world and the privately held business world. The publicly held business world has to make a return on assets, return to stockholders, and they have to make informed decisions, and they may choose to have a more limited assortment as does a Costco or as does maybe the Stop & Shop stores, unlike Bobby Ukrop as an independent because they're going to make that decision for different criteria.

You have to satisfy Wall Street versus satisfy mom and dad, that's a lot different in doing that, and I think it's a business decision that's going to be made each and every day by each and every competitor.

Again this is becoming redundant, but I think the real issue we have to be concerned with is, Are all of the promotions, the pricing and the products and the packaging being offered to all competitors on a fair and equitable basis? That is the more pressing concern than whether slotting allowances are hurting competition or doing anything like that.

MR. BALTO: Don Sussman?

MR. SUSSMAN: I go back to the fact that even if we have the biggest variety, we also have slotting fees so I think the empirical evidence says that slotting fees are not keeping variety down. Our stores have 30 to 50,000 items in them, and I guess if you're saying that we would have more items if we didn't get slotting fees, I have a hard time with that argument.

I don't believe that slotting fees are keeping variety down.

MR. BALTO: Yes, Bobby?

MR. UKROP: I feel like when push comes to shove the category manager is going to decide on behalf of our customers, and I think fundamentally long-term that's what's going to move a product. From an independent's point of view we're fighting the giants. You have to scrap for everything you can get, and what you don't want to find out is the guy down the street is getting something more than you're getting.

You may be getting more volume than those people, but you're not getting your fair share. That's why it's very important to have a level playing field, and I guess that's why we pay money for the FTC to watch dog, make sure that there is a level playing field in this area. It's not just slotting. It's a whole realm of things with the big guys versus little guys, public versus private, and competition at its best. That's the American way.

MR. BALTO: One more question. Should consumers care if promotional funds go into slotting allowances or other types of promotional funds such as better advertising, more couponing, things like that? Scott Hannah?

MR. HANNAH: Yes. If you've got a new product, I believe the number 1 objective is to make the consumer find out about it. If you're going to take the money which you could devote to media advertising or displays in the store or ads in the newspaper, then it doesn't make any sense to me at all, why would you take this money away from promoting that product and put in a slotting allowance and not say it doesn't affect the consumer. Of course it affects the consumer. She doesn't find out about it -- or he. Go ahead.

MR. WEBER: I think it's how you ask your question. Does the customer care?

MR. BALTO: Should the consumer care?

MR. WEBER: The consumer doesn't know.

MR. BALTO: The question, should the consumer care?

MR. WEBER: But frankly I think that the slotting allowances generally are a very small percentage of the total cost of putting products into a marketplace. You may have an exception on some small brands where obviously it's a large percentage of the total costs. I would argue that slotting allowances do in fact create a barrier in terms of being able to introduce items with smaller brands as you've defined.

MR. BALTO: Bobby Ukrop?

MR. UKROP: I was going to ask the smaller manufacturers, what do you propose ought to happen to make it so there's a more level playing field for you, because I think it's got to be really tough? We're actually a small manufacturer as well. We sell baked goods to other people, and we haven't been confronted with this issue yet because we don't have any customers yet at this stage. But I guess in a way we sell to our friends, the people we know that are our size, who don't ask us for those things.

I guess if you could paint a picture for the FTC what would that be?

MR. HANNAH: Yes. Again I mentioned earlier I worked for some pretty big corporations but if you come in as a pretty small manufacturer like myself and the man from Oregon, and you have to charge those slotting allowances totally against the product that you're bringing in, it is impossible. I'll sit down with any of the retailers and show you on paper that if you're a conglomerate and you can spread that slotting allowance over a hundred, 200 items in that store, yes, as the man down there said, it is not a big deal, but be careful how you look at that. See my point?

MR. CAMPBELL: But hasn't the market responded with specialty retailers as well? You have gourmet, specialty food. Now you've got natural food, ethnic foods, and it's opened up a whole wide array of opportunity for people to sell goods at.

It doesn't mean it has to be in the supermarket operation. I can understand that you may not get it into a Stop & Shop, but you may get it into a local independent and have the breathing room for a particular item.

We see all the time Cajun and creole seasonings. People make it in their backyards, for God's sake, and they bring it up to us and want us to distribute the product, and in many cases the chain stores in our market go to our retailers and buy it off the shelf to put it on their shelf because they're not going to put it in their distribution center so they'll buy it off the shelf of one retailer and put it in their stores.

MR. HANNAH: Can I direct that? In the West -- I think you hit on new industry. I was thinking, a couple weeks ago in the West a company called Trader Joes out of Pasadena made a name for themselves by doing just this. There's an organization in Washington State called Washington State Specialty Foods Association, and these people, in their backyards practically, come up with some fantastic foods, but it blows them away thinking of getting into a Safeway or a huge chain with the cost.

And what they're being told by the consultants is that you need to get that store into the mainline supermarket, so it's very frustrating, very frustrating. But, yes, I think you hit on possibly a new way to go in the specialty store.

MR. BALTO: One last comment.

MR. SUSSMAN: Trader Joes is part of Oldies, which is a huge German company, and the bottom line is that there are many models out there with products introduced into the market differently. You asked does the customer care. The bottom line is I don't know if they care about the question, but they vote every day, and they vote where they buy and what they buy, and I think the market works.

MR. BALTO: Let me close off this panel at this point. Thank you everybody on this panel for excellent presentations and lots of really valuable information.

We thought it would be valuable for us to hear from Professor Steve Salop of Georgetown Law School who is a real expert in the area of exclusive dealing and exclusion and spends a little time nowadays thinking about how to split up a certain Fortune Ten company Steve has been nice enough to prepare some comments that will help us think about the issues that we're going to deal with tomorrow, especially in terms of exclusive dealing. The panel can continue to sit here. Steve, if you would step up the podium at the corner of the room to make your presentation.

MR. SALOP: Thank you. I think I'm going to repeat what Mary Sullivan said to all of the real world people at the front table. These are theoretical statements. I don't really know what I'm talking about.

But what David Balto asked me to do was to try to put the issue of exclusivity into an antitrust context, and so that's what I'm going to do. This is going to be very theoretical and really very much geared toward antitrust law and antitrust economics, not towards the scrappy real world of getting your individual products on the shelf, although I think one can make the connection.

What David asked me to talk about was how slotting fees can be used to raise rival's costs and raise barriers to entry, the scenario that I've done a lot on over time, so I'm happy to present it.

In this sense slotting fees are just a method of achieving exclusivity, just like any other method of achieving exclusivity that we've studied in antitrust. The basic idea is that by offering high slotting fees to chains in exchange for excluding new entrants, then the incumbent, dominant incumbent can benefit by erecting barriers to entry which can then deter entry or minimize entry to a limited number of stores, and in a sense marginalize it.

And under those circumstances, in the absence of sufficient competition -- that is, if there is insufficient competition among other established brands -- then the dominant manufacturer can gain power over price. It can gain the power to charge higher wholesale prices, which then will be passed on to consumers in the form of higher retail prices.

So under those circumstances, where the slotting fees both raise rival's costs and then more importantly from the point of view of antitrust give the manufacturer the ability to create or enhance or maintain market power in the downstream market, then there can be consumer harm.

In those situations, that just shows sort of gross consumer harm. Of course we've also been talking for the last two hours about the potential efficiency benefits of slotting fees in terms of allocation of scarce shelf space or risk shifting and so on, and those would need to be taken into account.

In the absence of offsetting efficiency benefits, then there would be net consumer harm. In the end this sets out a Rule of Reason antitrust analysis, where you first look at harm to competitors, then harm to competition, and of course offsetting efficiency benefits. That's sort of the headline of it all.

Now, this raises a number of questions, a number of antitrust questions. The first one, and the one that gets the most play among antitrusters, is why do you need implicit government intervention in this area? Why can't the entrants simply compete in the market for exclusivity? If an entrant has to compete in the market for selling their hot sauce, why not in the market for getting distribution as well?

And that's a legitimate question, but I think that the courts and lots of commentators have gone much too far in the direction of laissez faire on this issue because competition for exclusives is not competition on the merits. Competition for exclusives inherently is paying a retailer, not just for distribution of your own product, but more importantly for the exclusivity, that is, for not carrying, for not distributing other competing products.

And when you purchase the right to exclude, that's not inherently competition on the merits. That's not inherently pro-consumer. Only if those efficiencies lead to direct efficiency benefits, elimination of free riders and so on are there efficiency benefits, and that's not inherent in every exclusivity.

Indeed, the primary motivation and the primary effect of exclusivity may be the purchase of market power. That is, when you buy an exclusive, you're not just getting distribution. You're also attempting to buy market power, and where that can be shown, then there is consumer harm and there is room for government intervention. There's market failure.

This again raises the question, Would we think that the dominant firm would be more likely to win in the bidding for exclusives against an equally efficient entrant? And I think the answer to that is yes.

The reason why is because the incumbent is willing to pay in order to protect its monopoly power whereas the entrant is only willing to pay up to the competitive rate of return.

Let me present to you very quickly an example I use when I teach this. Suppose that you have an incumbent with monopoly power, and it's earning $200 or $200 million, whatever. Now suppose there's an entrant coming on the scene, and if the entrant gets distribution and succeeds in the marketplace, then the incumbent will only make $70 and the entrant will make $70.

Note that if you have competition, then aggregate profits are going to be $140 -- $70 each -- whereas if you had the monopoly profits would be $200. That's no surprise. Competition transfers wealth from producers to consumers, so naturally one would imagine that the aggregate profits when you have competition are lower than when you had the monopoly.

But take those numbers and translate them into the amount that the incumbent would be willing to bid for the exclusive and the entrant would be willing to bid to get on the shelf. The entrant might reason as follows: If I get on the shelf I'm going to earn profits of $70, so the must I would be willing to pay is

$70, hopefully I would be able to pay much less, but if I had to, I would pay up to $70 to get on the shelf.

The incumbent's decision calculus is somewhat different however. The incumbent would say, Well, right now I'm making $200. If the entrant gets on the shelf, I'll only be making $70 so the value to me of getting an exclusive is the increased profits, i.e. $130. I get $70 if the entrant's on the shelf. I get $200 if I'm alone. The difference, $130, is the value to me of keeping the entrant off.

So the incumbent would be willing to bid up to $130. Again the incumbent hopes that he can get it for less than $130, but if push came to shove he would be willing to pay up to $130. Well, in this example the incumbent wins the bidding. The incumbent is willing to pay up to $130. The entrant is only willing to pay up to $70. So the incumbent has a systematic willingness to pay more than the entrant does, and so the incumbent will tend to win the bidding for exclusives.

Now, obviously this depends on my numbers, right? You could pick any numbers you want, but what makes that result go is nothing more than the fact that the monopoly profits are bigger than the competitive profits.

As long as the total profits, i.e., the $200 number, are bigger than the profits that the two of them would make if there were competition, that is the $140 number, then it's worth more to the incumbent to keep the entrant off the shelf than it is for the entrant to get on the shelf. The reason why is because it's the purchase of market power. In my example the incumbent is paying in order to maintain the monopoly power that it has.

And for this reason you cannot count on competition for exclusives, or in the supermarket context competition for shelf space. You can't count on that to reach the efficient outcome.

This is a very general result. Severn Bernstein has done sort of that similar research with respect to airline slotting fees at slot-constrained airports, because it's a really fundamental microeconomic argument.

At the same time I want to stress this is not a deep-pocket argument. It's not like deep-pocket pricing predation. The incumbent's bidding advantage does not come from the fact that the incumbent has more money. The bidding advantage comes from the fact that the incumbent is already established on the shelf and the fact that monopoly profits exceed duopoly profits or competitive profits.

The entry barriers are raised because the entrant needs to outbid the incumbent, and that raises the entrant's cost of entry, and that's the barrier, and it's an artificial barrier to entry because the exclusivity was not intended to achieve an efficient benefit of internalizing free-riding or allocating shelf space efficiently.

What the incumbent was fundamentally buying was the right to exclude the entrant from the shelf. Where that's all that's going on, the incumbent will tend to win and that can be anti-competitive -- not always, but it can be.

"There's not a level playing field" would be a way to put it. I think somebody used that expression earlier. It's not a level playing field even if the exclusives are short-term, and even though I know there are a lot of cases that say that exclusive dealing, where the exclusive-dealing contracts are short-term, is virtually per se legal.

And what I'm really saying is that from an economic point of view that result does not make sense. Even if the exclusives are short-term, and can be undone on demand, the entrant faces a coordination problem. The entrant can't survive just by being on the shelf of one store. Entrants need to get a distribution network established, and they need to make enough money to maintain adequate investment and advertising incentives.

What the exclusive can do then is lead retailers to think that the entry's going to fail, that the incumbent will be able to outbid the entrant for the exclusive. That will in the first instance raise the fees that the entrant needs to pay, and will make it less likely that the entrant will get anybody to buy on.

In addition, if the exclusives are long-term, which they often are, and if their expiration periods are staggered, this will create a second coordination problem for the entrant. The period before which they could achieve viability is lengthened. It also increases retailer's expectations that the entrant will fail, and again that makes the retailer more willing to give the exclusive to the incumbent even if the slotting fee is very small.

So as a result, the fixed slotting fees can succeed in creating entry barriers without creating consumer benefits.

This brings me to last question, which is one that David Balto raised for me when we talked about this in preparation. He said, Well, why would the retailers go along, why would the retailers shot themselves in the foot by creating a monopolist or allowing this firm to maintain monopoly power as in my example? Don't they like competition?

The answer to that is yes. Retailers clearly like competition, they want manufacturers to be competitive. But there is a free rider problem, a public goods problem. A single retailer would have a tendency to ignore the effect of his conduct on the success of the entrant overall because the retailer is only one of many retailers, and the retail sector is highly competitive.

Since they ignore that, the monopolistic, dominant manufacturer can pay a number of retailers enough that they're compensated for the loss in competition, and then it can make money on the monopoly that it achieves with respect to others.

In addition, if the retailers think that the entrant is likely to fail, then they would be willing to settle very cheap. Suppose the incumbent says, Well, my price is a hundred dollars, I'll give it to you for $99. Now, it's true that if the entrant comes in and succeeds, the price will go down to $50.

So which do you want, do you want $99 or do you want to buy the lottery that it might go down to $50? Well, the retailer might think, Well, gee, I would like to go with the entrant, I would rather pay fifty. But if the retailer thinks the entrant is going to fail, a dollar is better than nothing, and if all the retailers think that, then the entrant will fail.

So you have sort of a chicken and egg problem. It means that the slotting fees may not even compensate the retailer for the loss of competition. Again, the reason why this occurs in an otherwise well-functioning economic system is the very reason why we have antitrust. Competition is a public good, and so you cannot count on consumers making deals with firms or retailers making deals with manufacturers, to ensure that competition will be maintained in a situation where you have potential for monopoly power.

So this theory is well within standard Chicago-based antitrust, although it reaches obviously a somewhat different answer. I'm also not saying, and I don't want anybody to think I'm saying, that these exclusives or slotting fees should be viewed as fundamentally anticompetitive or the FTC should follow some sort of per se rule or quick look rule towards slotting fees.

Quite the contrary. In my example, I have left the efficiencies out, but very often slotting fees do have efficiency benefits. Where they do, these need to be taken into account and balanced.

So what the FTC should be doing is running through a full Rule of Reason analysis on these things. Are competitors harmed as our rival's costs are raised? Are barriers to entry raised? Second, even if they are, is there sufficient competition among established firms to maintain adequate competition? And if the answer to that is that there is adequate competition, then the fact that competitors are harmed does not raise an antitrust question.

Where you've got not only competitor injury but also competitive injury, then there's a potential market power problem, and in that case you need to balance off the harm for the market power against the efficiency benefits that potentially accrue from the slotting fees.

So just as you shouldn't assume that the slotting fees are efficient, by the same token you shouldn't assume that they're inefficient or you shouldn't put in such a high "less restrictive alternatives" bar that no one could ever meet them.

Instead you should do the usual kind of full Rule of Reason analysis, and I think that's the sort of antitrust that we should use with respect to the exclusives.

Thank you.

MR. BALTO: Steve, why don't you stay up there.

If anybody has questions, you're a professor, and you're used to answering any questions. Does anyone want to ask any questions?

MR. REYNOLDS: I have a question. You said at one point that you didn't think this was a capitalization issue or an ability-to-pay issue but was just a straightforward case where it's more valuable to the monopolist than it is to the duopoly situation? .

MR. SALOP: Yes.

MR. REYNOLDS: Can you expand a little bit more on that? I think I would argue with that, that we are talking a lot about a deep-pocket kind of an issue.

MR. SALOP: Where there is a deep pocket issue there is a deep pocket issue. I'm not saying there can't be a deep pocket issue in addition, but even if it's two big corporations, even if one is Procter & Gamble and the other is General Foods, when Procter & Gamble first rolled Folger east, it was worth more to General Foods to maintain the Maxwell House monopoly than it was for Folger to bust in and create competition. Therefore, Maxwell House would have been willing to pay more than Procter & Gamble would have been willing to pay to get in.

MR. BALTO: Steve, what should we look for in terms of evidence of consumer harm? What would be the indicia you would look for in a good enforcement action?

MR. SALOP: Higher prices first and foremost. I would be worried about simply looking at a reduction variety because by definition, if you exclude a rival, variety goes down. Any time there's a supermarket merger, the person that lives across the street from the supermarket that was closed is worse off, but we clearly don't view that as sufficient to prevent efficient supermarket mergers, and I think I view variety the same way here.

MR. BALTO: Mary?

MS. SULLIVAN: I have a practical question, an empirical question, an observation I guess. When I go to the supermarket, I think I observe that there's a lot of products in each category. Now, some of these products are highly differentiated, so they might not be perfect substitutes with one another. I'm just wondering what that observation does to your theory, which views two competitors and says and one of them is going to end up with an exclusive.

MR. SALOP: Well, you know, I think if there are 50 brands of toothpaste and the exclusive only keeps out one more and the one they keep out isn't particularly helpful, that would be a situation where I don't see any harm to consumers.

But if there are 50 brands of toothpaste and the one that's coming in is coming in head-on against the dominant firm, if there were a dominant firm in toothpaste, and if it was really going to create much lower prices, then there would be harm to competition.

By way of analogy, there are 6,000 banks that issue VISA cards, so you think eliminating one VISA issuer would not make any difference, but when AT&T started issuing The Universal Card, all of a sudden annual fees went from $20 down to zero and really didn't come back.

Now, there's a situation where one very efficient large-scale entrant made a difference even in a situation where there were 6,000 competitors.

MR. BALTO: Please identify yourself.

MR. BLOOM: My name is Paul Bloom from the University of North Carolina. How would you observe lower prices when you don't really have the ability to have a Kroger? What happens if you didn't have the ability?

MR. SALOP: Good question. Good question. This is what makes antitrust hard. I'm a firm believer in econometrics to begin with. We use econometrics in major analysis and you can use econometrics here as well. Very often you'll have a situation I think where the entrant has succeeded in rolling out in part of the country but not in other parts of the country, so in that case you could do a comparison.

In other situations you might find that the entrant was in the market and then over time gets knocked out, is forced to exit, and then you can do a before and after type of study.

MR. BALTO: Bob Steiner?

MR. STEINER: Steve, one of the things that bothers me is perhaps partly a deep-pocket issue, and that is the format in which slotting fees are paid. In the grocery business it's pretty much a dollar and cents figure up front. In other business, we heard about the apparel business, and it's new in the home center business -- it's a percentage off the order, new order, new item allowance.

That way even a small manufacturer is going to be able to sell at above average variable cost from his first order. I know what I'm talking about here. Even Home Depot, which has got a lot of power, or Wal-Mart which has a lot of power, as I understand it do not ask for a dollar and cents amount up front, and that's what is a possible barrier to the entry to a smaller manufacturer. He can pay a percentage, he can't pay an up-front fee.

MR. SALOP: The way in which entry barriers are raised is just that way. An up-front lump-sum payment goes into the extra cost of entry. It's just like you need to build a plant or you need to pay something to the contract manufacturer, you need to pay something to the retailer as well, and it raises your capital cost of entry.

And it could put you in a position that you can't price above cost, in which case you won't enter.

MR. STEINER: I'm talking about the difference between a variable cost to the manufacturer and a lump sum fee.

MR. SALOP: I'm agreeing with you.

MR. STEINER: I didn't get that from your answer. Maybe some of the people on the panel want to talk about this. I think from what I've seen in accounting that a slotting fee goes mostly to headquarters. It goes to some fund, and it's not competed away, and if it were a variable cost in the food business, I think it would probably be competed away.

I've seen -- for instance I don't know how many of you have seen the March study, the Harvard Business Review case report. They have direct product pricing for every category, and they have assigned all the costs applicable to it, but then there's a little footnote that says certain things such as slotting fees are not allocated.

MR. SALOP: I think this is mainly something for the panel. What I heard in the period I was here was some members of the panel said it was passed on in terms of lower prices.

As an economist, what I can say is that microeconomic theory predicts that an up-front lump-sum payment, not conditioned on retailer performance would not be passed on in the short run, but by making retailing more profitable would have a tendency to lead to greater investment in the retail sector which could lead to more variety and ultimately more competition in the long run and ultimately to lower prices that way, okay?

It's also true in the work I've done that the distinction between lump sum payments and variable payment is too simple because sometimes lump sum payments are only paid if the retailer carries out certain performance, whether it's an end cap or cents off coupons or ads or other performance.

And in that case, the lump sum I think acts more like a variable payment because it incentivizes the retailer to do something that benefits consumers, so you pay the retailer say a million dollars in exchange for a promise that the retailer will lower the price of the commodity by 20 cents, that's going to be something that's going to benefit consumers, and that's just like -- in economic terms acts just like a reduction in the wholesale price.

MR. BALTO: The person in the back, and that will be our last question. We'll have time during the reception to ask more questions. Stand up and identify yourself.

MR. FLICKINGER: Sure, Burt Flickinger. Just one quick comment. I worked on the independent retailer side representing a lot of independents on the wholesaler side. The manufacturer side with P&G, and also the chain side. In the example that you gave, in terms of exclusivity, in many cases with slotting fees, aren't supermarkets still on net paying higher prices? Because in your Folger/Maxwell House example, I was part of that test market, and we took all of P&G's merchandising monies and slotting fees and passed those along to the consumers.

So before P&G introduced, we were selling Maxwell House at 2.49 an equivalent pound on sale. When P&G introduced Folgers we were selling it at 99 cents an equivalent pound.

MR. SALOP: Arrest this man. He's a predator in pricing.

MR. FLICKINGER: When I was working with P&G later, and we did have marginal agreements and slotting fees, most of the retailers we sold to passed the slotting fees on in terms of lower cost to the consumers. But even with slotting fees, we found that we oftentimes had to pay higher promotional dollars or an equivalent through Wal-Mart or a Home Depot or any of the other retailers, because in asking for price rollbacks they in a "total bucket of trade allowances" were asking for more and more money from us than the supermarket industry ever did.

And even with slotting allowances, aren't the other retailers that have more category dominance, more category exclusivity, getting greater resources than the supermarket channel even with the slotting fee?

MR. SALOP: This is an interesting observation, a complicated set of questions, and I think you've really made the transition from today to tomorrow. What I can say is that, as a theoretical matter, lump sum payments that are not performance business based, according to microeconomics do not get passed on.

Lump sum payments that are performance based or variable payments like promotional dollars per case, that's like a reduction in the wholesale price and will tend to get passed on. Now, there has been some economic theory done, most notably by Greg Shaffer who will be talking tomorrow, that has built economic models that show that when there are slotting fees, that tends to raise wholesale prices, not through a mechanism in which manufacturers say, I have to recover a certain amount of money, but rather through the competitive interaction among manufacturers. Under those circumstances they tend to lead to higher retail prices. But that is a model, and there are other models in which you didn't get that result.

So a key question, a key question for the FTC is, Under what circumstances do fixed slotting fees lead to higher prices versus variable slotting fees leading to lower prices? That's the $64 question.

MR. BALTO: Thank you, Steve, and thank you to the audience. The reception is on the 7th floor. Let me forewarn you, this is an FTC staff sponsored reception so you shouldn't expect anything extravagant.

The 7th floor is known as The Top of the Trade which also serves breakfast and lunch, and tomorrow's lunch is fried chicken.

For those people who are interested, we should be distributing a copy of Steve Salop's paper tomorrow. And we look forward to seeing you at 8:30 tomorrow morning.

(Time noted: 5:20 p.m.)

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C E R T I F I C A T I O N   O F   R E P O R T E R

CASE TITLE: <u>WORKSHOP ON SLOTTING</u>

HEARING DATE: <u>MAY 31, 2000</u>

I HEREBY CERTIFY that the transcript contained herein is a full and accurate transcript of the notes taken by me at the hearing on the above cause before the FEDERAL TRADE COMMISSION to the best of my knowledge and belief.

DATED: JUNE 15, 2000

Debra L. Maheux

DEBRA L. MAHEUX

C E R T I F I C A T I O N   O F   P R O O F R E A D E R

I HEREBY CERTIFY that I proofread the transcript for accuracy in spelling, hyphenation, punctuation and format.

Diane Quade

DIANE QUADE

OFFICIAL TRANSCRIPT PROCEEDING

FEDERAL TRADE COMMISSION

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SLOTTING ALLOWANCES WORKSHOP

VOLUME 2

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FEDERAL TRADE COMMISSION

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In the Matter of:)
WORKSHOP ON SLOTTING ALLOWANCES.) Volume 2
----------------------------------)

JUNE 1, 2000

Room 432
Federal Trade Commission
6th Street and Pennsylvania
Ave., NW
Washington, D.C. 20580

The above-entitled matter came on for panel discussion pursuant to notice, at 8:30 a.m.

PANEL 2: POTENTIAL EFFECTS OF SLOTTING ALLOWANCES: CONCERNS OVER EXCLUSION AND EXCLUSIVE DEALING

PANEL 2 MODERATORS

DAVID BALTO, FTC
BILL COHEN, FTC
NEIL AVERITT, FTC

PANEL 2 GUESTS

SCOTT HANNAH (Pacific Valley Foods)
VICTOR THOMAS (Ahold)
KEVIN HADE (Ukrop's)
TOM STENZEL (UFFVA)
GREG SHAFFER (Economist)
JOHN EAGAN (Costco)
DAVID NICKILA (Portland French Bakery)
KAREN CARVER (Elan Natural Waters)
JACK MCMAHON (Gallant Greeting Cards)
PAMELA MILLS (Tortilla Industry Association)
GUS DOPPES (California Scents Air Fresheners)
MIKE WHINSTON (Economist)
GREG GUNDLACH (Marketing academic)

P R O C E E D I N G S

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MR. BALTO: We're going to start promptly at 8:30. I'm David Balto. This is day 2 of the slotting allowance workshop. Today we have a busy schedule. We start off with the panel on the question of exclusion. We follow with a panel on retailer market power.

Today's lunch, as I mentioned earlier, in the cafeteria on The Top of the Trade, 7th floor, is fried chicken with homemade potato salad.

Following that, we're going to have an interesting panel on category management and an exciting videotape to show you about how not to do category management, and that will be followed by a panel of expert lawyers and economists from all over the United States who are going to tell the FTC what they should do.

Let me start off with a couple of housekeeping notes. If you want materials from this conference or additional materials, it would be very helpful if you registered, and we have registration sheets out in the front. We are going to prepare copies of all of the handouts, including Professor Salop's paper, and they'll be ready for distribution sometime later on this morning.

I wanted to ask the panelists to try to be very careful about terminology. I heard yesterday a couple comments from people that we seem to be periodically confusing slotting allowances -- up front payments for new products -- with pay to stay.

So if you could try as much as possible, when you're using terminology that a layperson, someone who is not experienced in this field, may not be familiar with, please identify what you're talking about. Specifically when we're talking about slotting allowances, let's try to make it clear whether we're talking about something for new products or for incumbent products.

This morning we're starting off without a court reporter, so I want to emphasize as much as possible that when you speak, at least for this first panel, please identify your name before you speak, so the court reporter later can transcribe that.

In addition, we're accepting written comments. We've actually received one set of written comments, two sets of written comments, and those will be posted on our web site.

If you want to submit written comments, you have up until June 23 to do so.

With that, let's begin today's panel. Let me turn to my right. Neil Averitt is walking into the room, and Neil was the first person to introduce himself. Why don't we introduce ourselves counterclockwise beginning with Professor Whinston.

MR. WHINSTON: Michael Whinston, professor of economics, Northwestern University.

MR. STENZEL: I'm Tom Stenzel, president of United Fresh Fruit and Vegetable Association representing growers and shippers of fresh produce.

MR. HADE: Kevin Hade. I'm vice president, category management for Ukrop Supermarkets.

MR. GARMON: Hi. I'm Chris Garmon. I'm an economist here at the FTC.

MS. CARVER: Karen Carver. I'm the CEO and plant manager of Elan Natural Waters.

MR. MCMAHON: I'm Jack McMahon, president of Gallant Greetings, a greeting card publisher.

MR. THOMAS: I'm Victor Thomas from the Stop & Shop Supermarket Company.

MR. HANNAH: I'm Scott Hannah, CEO of Pacific Valley Foods. We're a processor of potato and vegetable products.

MR. GUNDLACH: I'm Greg Gundlach, professor of marketing, Mendoza College of Business at the University of Notre Dame.

MS. MILLS: Pamela Mills. I'm with the Tortilla Industry Association and also a tortilla manufacturer.

MR. TADA: Pierre Tada. I'm the chief executive officer of Limoneira Company. It's a produce grower, packer, shipper, and also involved in frozen food processing.

MR. FLICKINGER: Burt Flickinger. I teach in the food industry management program at Cornell University and St. Joseph's University, and work with a lot of independent retailers and small manufacturers and agricultural-based cooperatives.

MR. EAGAN: John Eagan, vice president, general merchandise manager, Costco Wholesale in Los Angeles.

MR. NICKILA: David Nickila, Portland French Baker, Portland, Oregon, a small wholesale variety baker.

MR. SHAFFER: Greg Shaffer. I'm at the William E. Simon Graduate School of Business, University of Rochester.

MR. COHEN: I'm Bill Cohen in policy planning here at the FTC.

MR. BALTO: And I'm David Balto. Let me remind you, the members of the panel, of the rules. I will call on people periodically to be recognized. Please place your name card up. We have a lot to do today, so please try to keep your answers relatively succinct.

By the way, if Gus Doppes is in the audience, we have a place assigned for you up here at the table next to Pam Mills.

Let me begin by calling on Karen Carver, Jack McMahon, Pam Mills and Pierre Tada and ask you to give the audience a view on how slotting allowances affect your ability to compete, your ability to enter into new markets, your ability to expand and innovate.

Why don't we start with Karen Carver.

MS. CARVER: Thank you. In our industry, which is of course the water industry, the slotting fees present a major stumbling block for us to enter into any large distribution network. We have had limited success in our regional area, but when you try to expand outside of that the up-front price of each SKU, depending on flavor and size and everything, it may be the same product, but you have the slotting issue for every single flavor and every single size.

So for us to get into a large supermarket, you're talking $50,000 or better up front, which we cannot provide because of the high outlay of capital which we just don't have.

MR. BALTO: Karen, what is the amount per SKU per store that you typically face?

MS. CARVER: Typically the amount has been $5,000 for each SKU in the markets that we've tried to go into. Some are lower. The smaller they are, of course the lower they are, but if you have a large distribution, then they want a larger amount up front.

MR. BALTO: Jack McMahon?

MR. MCMAHON: The greeting card industry is a 7 and a half billion dollar market with two majors having 80 percent of the market. It's a very fragmented marke with some 800 publishers such as ourselves.

We ourselves have lost a few pieces of business because we did not give a slotting allowance, and one piece of business was $5 million for a five-year contract which we passed on, and we lost another one fo a million dollars. It's a very competitive market and yet we would be in the top ten of the publishers in the industry.

MR. BALTO: Karen.

MS. MILLS: Pam.

MR. BALTO: Sorry, Pam Mills.

MS. MILLS: In the tortilla industry our compan in particular has been in business for over 43 years, s we have had market share, consumer demand, product quality, pricing, all of the above, but what's happened now is that we're being squeezed off the shelves because the dominant manufacturer pays so much money.

As far as other type of markets such as box stores, we were in one. The dominant manufacturer came along and paid a lot of money, and we haven't been allowed in that store since.

MR. BALTO: So in your situation there are pay-to-stay fees?

MS. MILLS: Oh, yes, annually.

MR. BALTO: And approximately how much per SKU are they?

MS. MILLS: In the tortilla market, it's nothing like SKUs. It's basically you pay five, six digit numbers for an annual program.

MR. BALTO: Pierre?

MR. TADA: Yes. I'm in the fresh produce industry, and one of the challenges of the products we produce is there's a time limit on the product. So there's tremendous leverage from the retail side if the product can't be sold. So you either sell it or smell it in our business.

Anyway, yesterday was an alien world that was being described by some of the folks on the other end of the value chain. Let's be real. It isn't just slotting fees for new products. It's pay-to-stay, and it has a tremendous impact on small growers and shippers who cannot afford to pay or are faced with the hammer of smelling their product at the end of the day.

So it's a very different world from our perspective. There's huge leverage against suppliers, even more pressure on trade allowances, and a conscious effort of retailers to push all costs of doing business back on the supplier.

MR. COHEN: When you say pay-to-stay, how frequently are you paying? Annually?

MR. TADA: Well, I got together with a group of CEOs who were fearful of showing up at this meeting for fear of retribution, but it varies from annually to the whims of the other side of this value chain.

MR. BALTO: Mr. Tada, how do you find the trend of slotting allowances changing over the past five years?

MR. TADA: That was also an alien world that was described yesterday. It's gotten much more intensive. Let's face it, some of the retail models that exist today no longer work, as evidenced by some of the changes in the channels. There is a conscious effort by retailers to push back the cost of business back on to suppliers, so it's much more intensive, and even moving towards a traditionally light area which is in the fresh produce area.

The only thing that saved us is most of the products are sold in bulk supplies, and they move around beating down prices, and they don't really commit to a particular supplier.

MR. AVERITT: Could I ask the manufacturers to help us put this in context? We've been describing so far starting allowance in absolute terms -- how large are they or how much are they per SKU store. To assess their impact on your capital requirements, what percentage do they represent of the capital costs of bringing a new product to market? How big a factor are they in the calculation?

MR. HANNAH: Yeah.

MR. BALTO: Identify yourself.

MR. HANNAH: Scott Hannah, Pacific Valley Foods. Correct me if I am wrong, this is what I was referring to yesterday where you take like a market like Seattle, take 200,000 in slotting, 150 in media, 150,000 in trade promotion. Is this what you're referring to?

MR. AVERITT: Well, that's certainly a long way toward what I had in mind. I was wondering if you could think of this in the context of all of the costs of developing a new product and bringing it to market -- such as the cost of your research or of setting up whatever manufacturing facilities you need? How big an increment would this make to your capital costs?

MR. HANNAH: Then I would have to do a little calculating and I could reply later. I did a real quick calculation just taking 30 second. Take slotting allowances alone: 35,000 supermarkets in the United States, give or take, some say 33,000, at $150 a store, one item would be $4.2 million up-front cost, immediate payment, no cash flow. Four items would be typical. You're looking at $16.8 million, and that is ridiculous. I'll answer your other question and do a little calculation.

MR. AVERITT: Thank you.

MR. BALTO: Do any of the other manufacturers have a sense of the degree that slotting allowances increase your cost of entry? Have we been talking about 10 percent, 20 percent? Or is this not a meaningful way of looking at it?

MR. DOPPES: Gus Doppes from California Scents. I believe the slot, if you take nationwide distribution, it would be in excess of 50 percent of the cost of bringing a product to market.

MR. BALTO: Any other of the manufacturers have a view on that? Are your figures different? We're just dealing with ball park figures.

MR. COHEN: You base that on national distribution. What has been the experience of the manufacturers at the table of distribution at less than a national level? Is that an alternative?

MR. DOPPES: That depends what markets you're in. If you go to the California market, LA, or New York or what have you, it can be higher than that. If you go to your secondary markets where there's not as many of the major chain players, then your cost would be somewhat less.

MR. COHEN: I guess what I was getting at: Is it a reasonable alternative to bring a new product into a region or just a certain fraction of the stores, of chains, or must it be nationwide?

MR. DOPPES: Well, with limited capital, you're restricted to a limited geographic area then.

MR. BALTO: Well, let me follow up on Bill's question. Don Sussman from Ahold described a scenario yesterday where they're willing to take on a new product by sort of trying it out in a few stores, seeing if it succeeds and then basing their decision partially on that.

Now, is that something -- I'm asking the manufacturers, is that something that you've seen out in the marketplace? Are retailers willing to do that?

MR. DOPPES: It's a rarity. And the reason for that is it takes as much of their manpower and time to set up a test as it does it to do their entire chain. All businesses out there are so -- the employees are -- their time is maxed out, so even if upper management might have a goal to bring in some smaller businesses, by the time it filters down to the buyer level -- "we have to implement the programs" and all -- they don't have time to do it.

And it becomes more of a monumental pain for them to try to accomplish it than to deal with their regular suppliers, so you can find that in a rare exception, but it's extremely rare, just due to the constraints on everybody's business.

MR. BALTO: Pamela Mills?

MS. MILLS: It's been my experience in looking for new business, such as in the box store industry where there's high volume, that as a small manufacturer we are basically used as the pawn to ante up the stakes. Once you make your presentation, you show them what you have, which is not heavily invested with capital, they're not very interested, but they'll use you against your opponent to get them to achieve their goal, as more money.

MR. BALTO: Are there ever situations where a manufacturer pays slotting allowances, and there's some kind of fraud that occurs, such as you pay the slotting allowances up front and then the product isn't actually taken for the period of time? Burt Flickinger?

MR. FLICKINGER: Thank you. Hopefully this will provide some perspective because there are there are many opportunities in terms of retail distribution, supermarkets, mass, club, convenience. If you look at a number of the success stories that we've worked on, both through the universities and clients, all these folks are represented in categories at the table here. Krispy Kreme Donuts and Bakery, just not a lot of money to spend, had gone bankrupt a couple times because of bad management, no slotting fees, but through good new management and public relations went multi-regional and then went national, and supermarkets were a big part of it.

Zatarain's leveraged seven times out of New Orleans, multi-regional and then went national. They helped develop the water category in the United States over the last 25 years from San Pelegrino. Evian from a single restaurant, and Starbucks, Rich's, Sorrento, Freezer Queen, all these guys started through supermarkets and got the support. There wasn't a lot of slotting allowance, and then they wound up going national.

And it was a grass roots effort with sampling and a lot of offer things that really helped drive it, and supermarkets were the partners.

MR. BALTO: Thanks, Burt. We're going to get to the story from the other side of the table in a few minutes. I wanted to focus initially on the impact on manufacturers, but that was very helpful.

There was a scenario painted yesterday that manufacturers seem to be -- I'm sorry, retailers seem to be relatively willing to negotiate slotting allowances. Let me ask the manufacturers and producers again to what extent is that true in the marketplace, and has that changed over time? Yes, Karen Carver?

MS. CARVER: We have had some negotiations with the retailers. They are willing to negotiate within a certain realm. You wind up with basically the same payout. It may just take on a different form as in trade outs, or I don't know how to explain it, but you were talking about the issue of will they work with you on regional basis or with smaller numbers of stores.

And we have not experienced that. It's been either an all or nothing, and it's not only the grocery stores but the convenience store chains unless you go with a small mom and pop chain that may have five or six stores, and then they're more willing to work with you, but if you get into the regional areas, then they want an all or nothing clause.

MR. BALTO: Can I ask the other manufacturers what you find in terms of the willingness to negotiate? Pamela?

MS. MILLS: One of my buyers said basically -- I asked him if this was negotiable, and he said only up.

MR. BALTO: David Nickila, what's your experience in terms of your ability to negotiate slotting allowances?

MR. NICKILA: Fortunately for us we've only had one case of this, although it's coming on the horizon because we've got other letters from the manufacturers, from the grocers, saying that they're going to standardize basically the two free cases to get into a new store. The two free cases per SKU which I stated yesterday was $568 for the SKUs that we were putting in this store.

And throughout the whole year we couldn't recover that, and right now the sales are even below what it would take to recover that. But we have gotten two other letters from a couple of the other chains saying that if this isn't acceptable or if this isn't what you're going to accept, please let us know.

So we're starting to face it now, and it's something that in the perishable industry we haven't seen before.

Very possibly the larger bakeries in our area · we're a bakery about $7 and a half million. The other bakers we compete against in the supermarkets are abou $150 million on up to about $600 million, so we're not in the same arena with them and are not able to pay th costs that I'm sure that they're paying to some of the chains.

But like I said, as of now because of our size we hadn't seen anything until just at the end of 1999. And that's the reason I'm here, because I am concerned Mr. Burt Flickinger just stated that, yeah, these big companies started out with grocer cooperation, and I made myself a note, that's like the old days, and like said this seems to be going away.

With all the consolidation of the chains and s forth, I don't believe that it's going to get any better. It's going to be more difficult for a small bakery, any small company to go to a grocer, try to ge their cooperation and develop business and develop sales.

I think these details of the wonderful Starbuc and everything else are a thing of the past almost.

MR. FLICKINGER: The Krispy Kreme example is within the last year.

MR. BALTO: Scott Hannah?

MR. HANNAH: Right here.

MR. BALTO: Actually I meant Tom Stenzel on that. I was looking over at Tom.

MR. STENZEL: Thank you. Tom Stenzel. I would like to add a perspective from the fresh produce side of the business. The first thing I would say is that the retail community is not monolithic by any stretch of the imagination. What we're probably talking about are the most egregious abuses that occur because those kind of stick in the craw of producers and manufacturers.

From our industry perspective, we would agree with Professor Gundlach's analysis that the fresh perishable side is much more moderate in the use of slotting at this point, but we see it coming to the industry, not so much in a new product introduction capacity, but clearly this pay-to-stay arrangement that several people have mentioned.

Whether it's an annual or a seasonal type arrangement, it's -- we're just starting the California tree fruit and grape season coming on now. Those suppliers of fresh produce are being asked to make substantial up-front cash payments in order to have distribution. The problem several people mentioned is in a commodity program, an easily substitutable market, there are 50 different grape suppliers who are eligible to choose from on any given day, so basically they are often played one off against the other.

I think from the perishable standpoint we see a very different dynamic, and it's kind of a unique situation in terms of the easy substitutability of our products.

MR. BALTO: Let me turn to Scott Hannah.

MR. HANNAH: An answer to your first question for David: The negotiating has gone down over the past few years on slotting allowances. In the frozen food business we find little or no negotiating. I want to go back, I borrowed a calculator from my wife so I could calculate Neil Averitt's question on capital.

If you go into only the Seattle market, for example, and you come out with not just a new flavor but a product you put a lot of R&D into over a five-year period, we've spent approximately $200,000 in R&D, and adding up all the other capital costs, slotting allowance would be 30 percent of those capital costs in the Seattle market.

If you expand out into a region, your R&D costs of developing a product of course are fixed. You've already spend the $200,000, but your slotting allowances have gone up tenfold. You've gone into ten Seattle type markets, which would include LA which is like 7 or 8 percent of the U.S., so now slotting allowance is 50 percent of your capital costs.

Is that the answer you're looking for?

MR. AVERITT: That's very interesting. Thank you. Are there some further implications that could be drawn from those figures? Do those tend to indicate that slotting allowances would be greater or smaller as a hurdle for smaller businesses to overcome?

MR. HANNAH: A small business as opposed to a large business, corporate business?

MR. AVERITT: Exactly.

MR. HANNAH: Again, the only thought that I could make on that would be that the slotting allowances for a larger company could be spread I think over a broad base of products and would not have to be charged solely to those new products.

MR. AVERITT: Would that be affected by what percentage of the product lineup of any particular company consists of new products, and what part consisted of existing items?

MR. HANNAH: Could you rephrase that?

MR. AVERITT: Would small companies, companies in your position, tend to be introducing new products more frequently? Would they be a larger percentage of your product lineup, and would you therefore be looking at slotting allowances more often than --

MR. HANNAH: Now I understand, exactly. Yes. As a very small company, to develop your market and expand, you would be developing more products trying to get more space, so it would be a higher percentage if that's what you're looking for. You don't have that broad base that you either bought or acquired to absorb those costs, so it would be a higher percentage.

MR. BALTO: Mike Whinston?

MR. WHINSTON: Mike Whinston, Northwestern University. I just had a question to follow up some of the comments that are being made about negotiations. A lot of the comments so far have been suggesting that the slotting fees are difficult because of capital constraints; that is, they raise the cost of getting to market.

I'm wondering, in terms of negotiation, the answers so far seem to be about the levels of slotting. But to what extent is there an ability to negotiate in terms of, well, maybe I won't pay you as much or as high a slotting fee but I'll give you other, better terms -- terms that are better, lower wholesale price, more promotion, that would be easier on capital -- that is, that are more sort of out in-the-future expenses.

MR. BALTO: Any manufacturer? Identify yourself.

MS. CARVER: Karen Carver with Elan Natural Waters. To answer your question, we have tried that as our first ploy every time -- that we'll give you a better product at a lower price, which spreads out that up-front money over the life of however long you're in the store, and they're not interested. That is an absolute. They're just not interested.

MR. BALTO: Do other manufacturers have experiences similar to Pam Mills?

MS. MILLS: My experience is that my company came together with two other geographically located companies to have the ability to serve over 350 stores with direct service delivery. We came up with a private label program for this particular chain of stores where we basically did their private label selling that product at our cost. But in order for the program to be successful, we needed to have our branded label product accompany that product with at least two-thirds of the shelf space.

So basically the private label was one-third, and our branded label was one-third, and we serviced these stores five days a week DSD accompanied by promotional items, discounts, ad rebates, demos in the stores, recipes, I mean, the whole gamut, and then it came down to net, net, net, what was the bottom line per unit cost in the system.

It was very successful, but when the dominant manufacturer did not receive the program, they were very aggressive with the independent chains and went after them specifically at those specific chains, and therefore the program is dying, and it's not supported by this group that we had joined.

MR. BALTO: So what did the dominant manufacturer do to --

MS. MILLS: Because there are a lot of different chains involved in this one association, and he went to them singly, to their corporate headquarters, and offered a lot of money directly. Basically it diluted because they added more displays into the grocery stores. It diluted and stagnated our sales specifically on the private label which was at cost.

I mean, you can't get any cheaper than that, and therefore it just stifled our sales.

MR. COHEN: You keep referring to a dominant manufacturer. Are you talking about a situation where we're really talking about only one company being on the shelves with the slotting, or is there more than one brand still appearing?

MS. MILLS: Well, the dominant manufacturer basically gets whatever they want. They have basically taken over the industry in the last ten years. They're controlling over 80, 85 percent of the marketplace or more.

MR. BALTO: So in effect are they buying exclusivity through slotting allowances?

MS. MILLS: Oh, yes.

MR. BALTO: Are there specific exclusivity provisions that are tied to the slotting allowances?

MS. MILLS: Yes, yes.

MR. BALTO: Let me ask you a question: I want to try to distinguish between up front cash payments and other types of things. I don't know if it's appropriate to do that or not, but to a layperson, when you hear that somebody requires free goods up front, that sounds sort of procompetitive. Someone is bringing on a new product. They're requiring the manufacturer to provide them free goods. That enables the retailer to offer a special attractive low introductory price.

And it sounds like that's something where everybody should benefit, the manufacturer, the retailer and the consumer. Is that the case? Scott Hannah?

MR. HANNAH: Scott Hannah, Pacific Valley Foods. Whatever you describe it, it's still a horse. It doesn't make any difference whether you give them a check for $50,000 or ship them a truckload of product and they deduct $50,000 from the first invoice, which is free goods. I don't see the difference.

And then to answer Mike's question earlier, no, there's no negotiating whatsoever anymore as far as term payment. You're paying term payment. You're already in a negative cash flow for the first year or two years anyway on a new product, with your trade allowances, your media advertising, your extra quarterly promotions paid.

And the slotting allowances is cash up front, and at $9 billion a year collected by the retailer for slotting allowances cash up front, it's a heck of a cash cow, and that's it.

MR. BALTO: Burt Flickinger?

MR. FLICKINGER: Thank you. About your and Neil's collective points in terms of capital requirements for small suppliers, within the last 14 months, the way Zatarain's did it was they went through the "all other market" and Green Grocers and DotComs, and then as they paid slotting allowances to supermarkets, through their old manufacturing plant in

Louisiana, they were able to get better manufacturing line time efficiency. This increased profitability, which allowed them to expand market by market throughout the United States, and it required limited, very limited cap ex.

They were competing against what some people would consider dominant manufacturers, Uncle Ben's, Lipton, and Quaker Oats with Rice-A-Roni, and they still became the fastest growing product in the category and with very limited budget, but just a very good strategic business plan in terms of rolling out across the country.

MR. BALTO: Thank you. We'll pick up on that later. Let me go back to the manufacturers. Are there situations where manufacturers pay to have you placed in a disadvantageous shelf location? We heard yesterday that those kind of things don't occur. Pam Mills?

MS. MILLS: They occur all the time. In one of the box stores that I had a contract with, where they discontinued some , when I brought up my contract, we did have a physical contract, I said, We have three years and we were only at year two. Basically he wasn't happy with that, and he put us in -- only three feet in a corner, and the dominant manufacturer came in, took the majority of all our space.

And so we had to work that little three feet. Luckily it was in the same town, so we worked that space probably like three or four times a day to keep our sales up, so we had to work twice or doubly hard as anybody else because we only had a little three feet, but we were moving the product.

MR. BALTO: Is there some point where space becomes so disadvantageous it's just not worth serving the customer?

MS. MILLS: Yes.

MR. BALTO: What's that kind of situation?

MS. MILLS: Well, when you're reset. Because annually with the dominant manufacturer, they give their new program for the chain stores, and basically we get a letter, You're going to get a reset on this date and then they show you the schematic, and really it's not negotiable at that point.

You just have to flow with it, and you get reset on that date. And if you don't show up, they'll just basically put your product in a shopping cart, and you have to take the credits out of the store, and, yeah, then it's not cost effective to take a product to market.

MR. BALTO: Gus Doppes?

MR. DOPPES: David, could I address an issue two questions back that you brought up -- on whether slotting allowances do lower the price of the goods or the prices to the retailer?

The simple answer to that is, no, because as Don Sussman I believe said yesterday, the chains use slotting allowances as a profit center. I can't speak for all areas of the grocery store and the different categories within it, but like in the air freshener set, everybody has a certain category margin that they want to make out of the products on this shelf.

So if you come in and your product costs $1, they're going to figure whatever their mark up is and say it's going to be 1.50. The slotting allowance that you pay has no bearing on what the price of the product's going for be once it hits the shelves. It's apples and oranges, so what the manufacturer has to do is to build that slotting allowance into his cost of goods that he's selling to the grocery store, so now maybe that product that he's going to sell to the grocery store is 1.50, and it's going to hit the shelf at $2.

MR. BALTO: David Nickila?

MR. NICKILA: You asked about space and so forth. Yes, these things are purchased, and the major suppliers, they do take position and move you into a worse position. Along with that I'll give you one example, which we have with this one chain of stores.

If you were in a deli with our bakery products, most of the chains charge 10 to 30 cents an item, which is okay. I can understand that. It's in a nice traffic location. Everything else to up-charge our product over what we suggest with a margin of 25 percent is fine, and it's within their rights, and I don't have a problem with that.

But then when you get your position moved down, the dominant supplier puts in a secondary item at 99 cents. Now, here's an item that's a two pound loaf of bread almost. It's 99 cents where they take one of our items, which has a wholesale of 1.64, normal retail of 2.19, most of the grocers mark it up to about 2.29, 2.39, and they mark it up to 2.99.

Now, they've taken that -- one day they all of a sudden up-price all your products, and then right next to you they're running 99 cents on all the major player's products.

So you tell me, do you think there is anything to that, any basis to that, that they make money and take over space?

MR. AVERITT: Mr. Nickila, could you explain a little more how the decision process would work there?

To what degree were those decisions being made by the retailer, and to what extent were those decisions being made by the dominant manufacturer?

MR. NICKILA: Okay. The decisions were made obviously without any consulting of our firm. We just showed up one day, and as our routes went out they went to all this -- the stores in this chain -- and they found out this was the new strategy.

MR. BALTO: Greg Shaffer?

MR. SHAFFER: Yes, David, I wanted to comment on a point that was made a few minutes ago. The manufacturer might not care how the deal is structured for the retailer, so you could give the retailer a wholesale price break, free cases of the good or a slotting fee. But I think in terms of economic effects there's a distinction.

A lump sum payment doesn't translate into a bottom line price reduction for the consumer. If you give the retailer free cases, the only way the retailer can make money off of that is if it sells the goods. If you give the retailer lower wholesale price, again the only way the retailer can make money is if it sells the goods.

So in terms of the economic effects, while the manufacturer may not care about the mix of promotional package that the retailer wants, I think it does make a difference for the consumer, and the distinction has to do with whether the payment is a lump sum payment or whether it's a payment that's tied to volume.

There's a key distinction for the consumers so I just wanted to make a point that the consumer does care.

MR. BALTO: Scott Hannah?

MR. HANNAH: Yeah, I'm going to object to the point of slotting allowances as cash up front. It's not the same as free goods. Correct me if you made that statement.

The turnover of groceries in cases -- if you ship a truckload of groceries to a buyer, we're not talking about a three, four, five-week risk of sale. That product is usually turned within a week, sometimes three days in the frozen food business, so shipping a truckload of free goods or handing the guy a $50,000 check to me is identical and should not be confused.

MR. SHAFFER: It would be identical to you, but it may not be identical as far as the consumer's point of view. If you give the retailer an up front money, the retailer has no incentive to lower its price to try to sell more. It's got the money. It's a lump sum money. There's no marginal effect. There's no variable cost effect.

If you give free cases, the retailer has to move that. That has a potential of lowering prices for consumers, so it may no make any difference for you, but in terms of the consumer it may make a difference. That was all I was saying.

MR. HANNAH: Again I'm going to have to argue with you on that. It's an accounting thing, and I'll talk to you in private about that, but it has to do with receivables, payables, cash. To me it makes no difference whatsoever.

MR. NICKILA: Excuse me, Greg. I stated yesterday that we had this opening, and their basic policy was two free cases of every SKU. Well, you say that we're not providing them the two free cases. They just charged us the value of those two free cases for every SKU, took it out of our AR payment, so that's cash up front. That's not passing on the consumer.

MR. COHEN: Just returning one more time to the viewpoint and perspective of the manufacturer, is there anything special about the nature of slotting allowances and that type of payment, as opposed to other forms of possible support, which makes it difficult to raise the capital?

We often hear that the capital market should work, and if you have a good product, somebody should be there to provide the money. Is there anything about the slotting allowances that makes that difficult?

MR. BALTO: Scott Hannah?

MS. MILLS: I was on the Shaffer question.

MR. HANNAH: Neil, is this similar to what we talked about a little while ago, on the capital for slotting allowances or advertising with small companies?

MR. AVERITT: I don't know. I guess I had understood the most recent question to be slightly different, to be sort of more, Can you go to either banks for loans or to the equity markets? If you do, are the markets going to respond differently if you're there for slotting allowance money --

MR. HANNAH: This is a very key question and a very critical one for the survival of small business in that a small business has basically two sources of cash -- his own pocket (or his relatives' pockets or friends' pockets), or cash flow from the bank. And banks do not finance marketing in any way, shape or form.

They finance machinery, automobiles. They don't even like to finance your office building. They finance cash flow, so the answer is large corporations can float stock. They can float bonds. They've got many other sources of capital, and if you put out a new stock issue I'm sure the stockholders don't care whether that money goes to buy machinery or pay slotting allowances. Does that answer your question?

MR. COHEN: Uh-huh. Thank you.

MR. BALTO: Are banks less willing to pay for slotting allowances, or just all promotion money --

MR. HANNAH: Banks will not pay any marketing expenses, no advertising slotting allowances, and I'll tell you my bank is Bank of America. It's not some smaller bank. It's Bank of America, and it has not changed. I've been with other large banks. They will just not pay. I would like to hear from some of the other panelists, but they don't pay for marketing. I can't go to my bank and say, I want to open up Denver, it's going to cost $400,000, and here's the payout. They would say, That's nice, go ahead.

MR. BALTO: I would like to turn to some of the retailers. We've got Victor Thomas from Stop & Shop, Kevin Hade from Ukrop's and John Eagan from Costco.

Let me say at the beginning that one of the examples that people pointed to us, about the egregious nature of slotting allowances on consumer choice, was the fact that no place in Washington, D.C. could you find this salsa, Fred Imus Southwest Salsa. And true enough, you can't find it in the District of Columbia any place you go. But if you go to Boston to Stop & Shop, you'll find this all over the shelf.

So with that let me turn to Victor Thomas of Stop & Shop. Why don't you tell us how Stop & Shop tries to attract small manufacturers outside of the process of using slotting allowances.

MR. THOMAS: Thank you. Basically Stop & Shop, like other retailers I'm sure, recognized that it's a business imperative to bring in small manufacturers, local brokers, local grocers, local producers. In order for us to survive going forward, we have to have companies that recognize exactly what the neighborhoods in which they attract customers want.

We can no longer depend upon the Krafts, the General Mills and the Procter & Gambles to foster our business growth in total. Neighborhood marketing is basically where every single retailer is going to have to go. You have a diverse customer population. You have a diverse customer base in every single one of your markets, so therefore you have to go after some of these small manufacturers.

We created a supplier diversity process out of a business need. It wasn't because of anything that had to do with any pressure from any outside resources. Basically we're looking for those small manufacturers to come in and help us do a better job of marketing and merchandising to our consumers.

As a matter of fact, the president of our company, Bill Greiz (phonetic), didn't wait around for a process to be created. He said, Look, why don't we just invite 20 small suppliers to come in, invite them to meet with our category managers, let them get a chance to stand up, talk about their products, talk about their services, and talk about the advantages and the uniqueness that they can bring to our retailers.

MR. AVERITT: Mr. Thomas, could I ask you a couple of questions about how that plays out on the ground? One would be: What degree of flexibility does this give Stop & Shop? How finely can you chop your supply line? For what units of stores can you buy?

MR. THOMAS: We have a total of a little over 200 stores and across the markets in Connecticut, Massachusetts, Rhode Island, New York, and you have ethnic differences as well.

MR. AVERITT: I mean, could you buy for a group as small as 20 stores or as small as five stores?

MR. THOMAS: Yes, we can buy for one store. If there is a unique product -- as a matter of fact there's a product called a coffee syrup that you can only sell in Rhode Island. It's something unique to that area, and there are three or four stores in Rhode Island where the shelf has maybe eight facings of this coffee syrup where you can't sell it in any other location. So, yes, we can do it as small as one store or as large as 200 stores.

MR. AVERITT: I would think there's sort of two competing trends at work here. One is a trend toward supermarket consolidation, which might tend to make people look at bigger suppliers. The other is sort of a managerial and computer-competence trend towards more flexibility. How do those two balance out?

Clearly you've got the capacity to be flexible in some cases. What percentage of the whole do those cases represent?

MR. THOMAS: Well, basically it's forcing us to be better micro-marketeers. It's forcing us to actually go out and find more manufacturers and more resources at the local level.

MR. AVERITT: And, for example, would you know right offhand what percentage of your SKUs go to less than all of your stores?

MR. THOMAS: Offhand I wouldn't know what percentage. I mean, we carry thousands of SKUs. I can tell you that out of the hundreds of suppliers that we have in our database, I deal with over a hundred that are small suppliers. They supply some of those SKUs that you're talking about.

MR. BALTO: Victor, can you give us a little more detail about the program? How long has it existed? How many manufacturers are you currently bringing in? How regularly do you have programs to meet with these small manufacturers?

MR. THOMAS: Okay. Informally it started, like I said, with this initial business summit. The first one was in July of 1999, where we just invited 20 suppliers to come in and make presentations. Out of those 20 we actually made business relationships with 11 of those. We followed up with a second one in January of 2000, in which we invited another 20, and out of those we brought in another 11.

We're going to follow up again in July, and basically this summit is something that these manufacturers kind of got together and said, Can we come in and do a -- in the retail industry it's called a cutting, but it's basically a tasting. They want to come in and actually serve these products to our category managers, our senior management, and let them really try to the products and kind of get their opinions and get up and kind of talk about how well their business is doing at Stop & Shop.

The next summit is going to be in October. Actually the Connecticut Supplier Diversity Council is putting this together for us. They're going out and actually finding 12 suppliers that would like to come in and make presentations to Stop & Shop that are not doing business with Stop & Shop. And we're going to do that with the Massachusetts Supplier Development Council. We're going to do that with Rhode Island. We're also going to do that with New Jersey as well. So we're just going to go into each one of these markets and say, Look, our doors are open, come in, make a presentation. If you have a unique product we would like to talk to you about doing some business with us.

MR. BALTO: Do your competitors have programs like these?

MR. THOMAS: There are other retailers that have similar programs. I don't think they go to the level of Stop & Shop, but yes, there are other competitors. Wal-Mart has one. Target has one. HEB has one, to just name a few.

MR. BALTO: Outside of your program, what's your experience with the willingness to negotiate on the amount of slotting allowances?

MR. THOMAS: Actually, to tell you the truth we haven't talked about it. We talk about slotting in the context of they've asked me, What is slotting? Half of them don't know what slotting is when they first walk into our doors.

MR. BALTO: Half of the manufacturers?

MR. THOMAS: Half of the manufacturers or half of these small suppliers. The other half basically knew about slotting, when they asked the question, Well, okay, now we get to the point of how much is this going to cost me?

That's not even a consideration in my mind. What you need to do is come to the table with a unique product or a unique service, come to the table with something different. Slotting is not something that we discuss as far as whether it determines whether you get on the shelf or not.

MR. BALTO: Do you require some of these other things like free SKUs or a certain amount of up front product that's free?

MR. THOMAS: It's not a requirement. The requirement is that you're 51 percent minority owned.

MR. BALTO: Do you also have this for non-minority businesses?

MR. THOMAS: Yes. As a matter of fact we do business with over 80 local produce growers at Stop & Shop. 17 of those are either women or minority owned. The others are not. There's no slotting involved.

MR. BALTO: Let me turn to Kevin Hade who described the situation in Richmond at Ukrop.

MR. HADE: Thank you, Dave. Kevin Hade with Ukrop's Supermarket. I would first like to compliment what Victor is doing at Stop & Shop. It's probably an exception for a larger chain to be thinking that progressively. However, from an independent's standpoint, this is really how we do business.

I think, as a small local chain for 63 years, kind of how we differentiate ourselves from the large national chains is by providing additional variety to our customers and working closely with the local suppliers. If you date our organization back to the '30s and '40s probably it was primarily with local farmers thinking along those lines.

And of course as goods have become more sophisticated and packaged, we have small manufacturing businesses that pop up in our state, and we work very closely with all of them to put the product on the shelf. We actually can play a vital role in their long-term success by giving them that inroad or opportunity, whether we work them chainwide in our 27 stores or just in a handful of stores.

But consumers coming in, getting used to getting the products, then all of a sudden our competition sees that someone's buying that particular product, and all of a sudden it's showing up in other stores as well. It can be a very positive situation.

I can think of an example -- a Mrs. Fearnough's Brunswick stew product. I don't know if all of you are familiar with that, but it's a locally manufactured product. We started carrying it, and in Richmond it's a phenomenon. It's a very popular item in almost everyone's cupboards, and soon it actually grew out of the region even up here into the Maryland-Washington, D.C. area, so we've been very progressive in that area.

MR. BALTO: For these types of manufacturers, do you require slotting allowances or do you require other things such as a certain amount of free goods?

MR. HADE: No, we don't. And in fact, I would take it the other way. In some cases we're even investing in them to help them. Again we think this is a vital differentiation point for us as an independent retailer, a family-owned business, and we can't be Wal-Mart. We know that, but what we can be, we can understand our consumers and our marketplace. We know what they want. We know the people that live and work in our community and shop our stores.

And we think it's good business to help small manufacturers get started. In some cases I think the owners of our company have bent over backwards almost, to link small companies with the appropriate distribution channels or the appropriate consulting advice to help them get started, to take the unnecessary costs out of their business. I think it's something we've always done.

MR. BALTO: To get to the other side of the spectrum, let me turn to John Eagan of Costco.

MR. EAGAN: In the beginning of the club business, it was almost an imperative that we seeked out these small manufacturers. The supermarkets put a lot of pressure on the grocery industry as a whole, the larger manufacturers, to keep us out of products, so we encourage the small manufacturers to find unique items.

And the way we categorize items, or the way our selection process goes, is it has to have quality and it has to be a unique item to get in, first of all. Second of all, we look at what are they going to supply us -- to adequate supplies. And then the prices are considered.

We go so far now it's become part of our culture, we're seeking out these small manufacturers, these unique items. If we find a particular item in a restaurant that we visit or whatever, we will go and approach them to see if they can package it. We'll help them with the packaging. We'll help them with the manufacturing where we can. We'll give them manufacturers that we're aware of that do a quality job if they need a copacker.

In my California region -- Hawaii is part of that -- we have sought out probably 30 or 40 local manufacturers in Hawaii that service just one or two or four buildings over there, and we do it as part of the culture. It's ongoing.

And the fees, we really don't require any fees. We just want the best price that they can give us. To get these things started, demos in the club business is a big part of our business, and the tasting is almost required. If the manufacturer can't afford it, we do it ourselves. I'll pay for it.

MR. AVERITT: Could I get the views of the manufacturers on the points that were just raised?

MR. BALTO: Let's hold that question for just a minute. I wanted to turn to Burt Flickinger. One of the things that we've been interested in are stories where small manufacturers have been able to get to market successfully in spite of or with slotting allowances, and Burt had a couple stories that he wanted to relate to us.

MR. FLICKINGER: Thank you, David, and thank you, Neil, both.

Small manufacturers have worked very successfully through the State Boards of Agriculture and through the teaching universities, for example through Professor Anderson at Cornell University, and CoBank, which is the national cooperative bank for the grower producers. They've worked in New York state with the State Department of Ag, with Bruce Friedman in going to Topps, going to Price Shopper or going to Wegmann, setting up farmer cooperatives, and it's to the Ukrop's point that you need the farmer to be a successful point of differentiation.

And slotting is not a requirement because if you look at the average supermarket doing $5 million a year, the average Costco is doing $90 to a hundred million a year per store, 60 percent food, the new Wal-Mart Super Centers doing $65 million a year. You need the fresh new innovative product. You need the variety. You need the small suppliers to be successful and get consumer continuity and demand.

The Pennsylvania State Department of Agriculture is working very successfully through St. Joseph's

University in creating partnerships with Weiss and Acme and the independent supermarket chains supplied through wholesalers as well as the major chains and the other big box retailers.

And that type of cooperative partnership between the states, the universities and the chains has produced a number of farmer's markets and stimulated a tremendous amount of incremental business for the small business growers.

MR. BALTO: Okay. Go ahead.

MR. AVERITT: Let me see if some of those examples can be generalized or to what degree they can be generalized. We've just heard from several retailers, who appear to be particularly responsible retailers, indicating that they can provide small manufacturers with ways of bringing new products to market without large up-front capital requirements.

The small manufacturers can start evidently with a limited cluster of stores, and if the products work well, they can roll out from there.

What I would like to do would be to get the views of the manufacturers here as to how common an experience that would be. We've heard from some very responsive retailers. What about retailers generally? Do they show a corresponding willingness to buy for limited clusters of stores and allow you to roll out from there?

MR. BALTO: David Nickila?

MR. NICKILA: Yes, I want to address what John Eagan said from Costco. I've got to applaud Costco. I'm not here to endorse anybody per se, but when we started in 1985, Costco was one of our first two accounts. We had a chain of stores we delivered fresh bread to twice a day to get started, and then we asked Costco if we could get in there and showing them a 12 ounce baguette, and they said, no, you have to tape two of them together and we'll put it in the store.

But they showed that willingness to help the small guy from the very beginning. The buyer's name was Ed Dwyer. I'll always remember what he said, and this comes up about once a year, If you're not going to sell it here, you're not going to sell it anywhere.

But the main thing I want to say is that in 15 years, if we have price protection on an item and everything else, they pass it on to the consumer. They have not changed one iota, and I'll tell you what, some things are the same.

And to go along with that I also want to mention the fact that, when you look at an example like Costco, they really helped us when we got started, we try to do the same thing. We try to hold our pricing and keep the lowest price for the consumer that we can. We talk about we haven't had to face any of these major costs yet. They might be on the horizon, but we don't take pricing.

I'll tell you what we try to take and if things -- we've had gasoline skyrocket and everything else. We haven't taken any pricing. Many of the major bakeries look at any reason to raise prices, and they're obviously paying some other things that we're not paying.

We've tried to hold the line with efficiencies. And like I said I don't know if our 95 employees can get much more efficient, so we may have to take a price increase. We haven't taken one for three years, and the one prior to that was about four years, and like I said we've been that stable, and it's because we believe that we're trying to provide the best quality and service for the consumer, and we've been able to hold it up to this point.

But I want to say it's great to see a relationship that hasn't changed in 15 years.

MR. COHEN: I would like to throw this out to the manufacturers in general. We can talk about slotting allowances as payments to get your products on the shelves. I'm interested now in shifting to your experiences where you've come across payments in your brands being demanded, or being made, as a means of keeping others from having their products on the shelves. In other words, where you're buying not just your position on the shelf but you're buying exclusivity there. If not 100 percent, a percentage of exclusivity or a fixed, limited shelf space for your competitors.

What's been the experience in your various businesses?

MR. DOPPES: In the air freshener business, on the household side you don't see that. It's very prevalent on the automotive side of the air freshener business where companies are paying the retailers to have the exclusive right of the section, and we're not talking one or two SKUs. We're talking maybe 120, 130 SKUs where the dominant players will pay large amounts of money to keep everybody else out.

MR. AVERITT: Is the air freshener business one where in the absence of that kind of payment a retailer would normally want to have more than one manufacturer, or is it like some other products where maybe they want only a single supplier?

MR. DOPPES: Well, the household side of the business on air fresheners drives the business, and that's where the majority of the business is done, probably 70 percent of it. If it made economic sense, it would be done on the household side, but it's not, because there's so many products out there that generate large volumes of dollars that it just would not make sense for retailers just to have one household supplier.

The same is true on the automotive side, where the section would generate more money with three or four companies in there. But due to the cash payments that a few of manufacturers are making, they're getting the exclusivity, and the professor from Georgetown addressed it yesterday when he was talking about these large payments to stay in, and that's exactly what's happening.

MR. BALTO: Scott Hannah?

MR. HANNAH: This is to Bill's question again. Frozen food, frozen vegetables, frozen potato products, yes, you do have to maintain a level of trade payment as far as trade promotion, advertising, displays, TPRs, not necessarily to make the product move.

Some of your products are in the middle third, dividing a whole velocity up to the top third, middle third, bottom third. Take a product in the middle third. You can get into trouble if you don't commit to a quarterly amount of money that will go towards displays, outside displays, trade ads, shelf talkers, whatever. I'll get into the more serious nature of that when we talk about category management later, but I think that answers your question.

MR. BALTO: Tom Stenzel?

MR. STENZEL: Thank you. I really feel the need to go back to the concept of more than just access to the stores. I think the examples that were given were very good and accurate, but we're talking about many of the products that are already in the stores and then the demands that are placed on them. With all due respect to Burt Flickinger's comments, we're not talking about the six-week summer season for local tomatoes here. We're talking about 20, 30, 40 truckloads of tomatoes every week going into the store.

And I would ask the panel -- I want to give you three real examples that have occurred in the past year. One, a northeast chain that opened a new warehouse distribution center and then back-billed all of its suppliers their pro rata portion of the cost of construction.

The second example being another, different chain that was opening 20 to 25 new stores in this past year and sent a letter, Dear valued supplier, we're going to deduct $500 per store from your accounts because of the 20 to 25 new stores.

The third being most recently this fall in southern California, a remerchandising instance where the company through acquisition was merging several different formats and again charged a direct cash payment to all of its vendors in a form letter, Dear valued supplier.

Now, from our industry standpoint, again we're easily substitutable. When a produce company who may be in the market and have been a valued supplier says, No, I'm sorry, I'm not going to pay the $500 per store, they are moved out the next week, and with very little ability to negotiate. I do want to get that back on the table.

MR. BALTO: Pam Mills?

MS. MILLS: Can I add to that? Whether you want to pay it or not, they take it off your receivables.

MR. BALTO: Did somebody else want to comment on Tom's comment, because I want to push back on it.

I understand that this doesn't look particularly fair from the perspective of the manufacturer or the producer, but what we are concerned with from an antitrust perspective are things that harm competition and that will ultimately result in higher prices.

Why does it make any difference if a chain goes and sort of says, I want this pocket of money just because today's Sunday, versus they're just being harder in negotiating with you and just saying, Okay, instead of paying so much per bushel, I'm going to pay a dollar less a bushel?

Why does that make a difference to consumers here?

MR. TADA: Well, if anyone believes that pushing these costs back on the suppliers does not increase the potential for consumer prices going up is living on a different planet, because we're able to deliver product based upon our costs. In our view, it's one thing to have some of these allowances -- we call it a bucket of allowances, and you can call it whatever you want. Some of it is up front and some of it is back end and some of it is because it's Mother's Day.

Anyway, we feel that a lot of this is very arbitrary. Charge what the traffic will bear. It is unrelated to costs. It's prohibitively expensive for small companies. It stifles innovation, inhibits competition. It favors the big over the small, let's face it, and there is no accountability.

Does anybody here have real accountable, reliable information about what's really going on here?

I think the answer would be no because it is lost in the bookkeeping, but I think the main argument from an antitrust standpoint is it does stifle competition and increases prices to the consumer.

And the folks who are really at issue aren't the folks who are at the table today. I mean, think about Price Costco -- very innovative -- or Stop & Shop. The folks that are really at issue are not at the table today, and I think that's the point, and the folks who are most impacted by it are not at the table today for fear of being seen here.

So I'll just rest my comments there.

MR. BALTO: By the way, all those folks were invited. I want to come back to the competitive effects on entry and innovation, but I first wanted to break and give Mike Whinston, who's a very well thought-of professor at Northwestern University, a chance to make some remarks to us about how we should look at exclusivity. Then we'll tie that back in at the end with questions on entry and innovation.

Why don't you go up to the podium?

MR. WHINSTON: Thanks. David asked me to comment on the issue of exclusive dealing and exclusion, as well as more generally on some of what we've heard yesterday and today. My remarks will cover five topics.

The first is the question of what we mean by the word "exclusionary." Here I think it's important to distinguish between the common meaning of the word exclusionary and the usual antitrust meaning. Some cf this has been coming up just recently in the discussion.

For example, consider an industry that requires a certain input for production. Suppose also that this input is very expensive. Then in common parlance, we might say that this high cost or the high cost of this input is exclusionary. Some potential sellers may find that it's unprofitable to be in the market because of the high cost of the input, but this differs from the usual antitrust meaning of the term, by which we mean practices employed by a dominant seller that serve to reduce competition from rivals.

This is not to say that public policy might not improve on the market outcome in the case of an expensive input. For example, the high price might be because of market power in the input market. But at least the usual policy approaches to such things come in the form of merger policy and price fixing enforcement rather than in monopolization cases.

The second topic concerns the need to consider the whole range of the deal. By that I mean as opposed to focusing on just one term of the deal, namely an up front fee or a slotting allowance.

The first reason concerns what exactly it is that may be exclusionary. For example, one might be led to say in a certain circumstance that high slotting fees are exclusionary when, in fact, it may actually be some other aspect of the deal that is exclusionary. For example, there may be an explicit exclusionary term, and the high slotting fee may actually just be the payment that's being made in return for this exclusion being provided.

The second reason concerns the effects of prohibiting a given practice. For example, in this instance where there's an exclusionary term and a high slotting fee is a payment for it, what would be the impact of saying you can't have slotting fees? Well, it may be that eliminating slotting fees actually has no effect on exclusionary conduct and the likelihood of exclusion because other payments may be substituted in response to an elimination of a slotting fee.

The payment may come in other forms -- for example, an annual payment. To take it to an extreme, an annual payment plus a termination fee is actually exactly equivalent to a slotting fee, okay? So it's important, I think, to consider the whole range of what the relationships are, the contractual relationships, whether implicit or explicit, between manufacturers and the retailer in thinking about these issues.

The third topic concerns the theory of exclusionary contracts. I think Steve Salop gave a very nice introduction to this yesterday, and here I want to just expand on his remarks in two directions.

The first concerns what kinds of exclusionary provisions we might see. In the purest form, of course, we might see a pure exclusionary term that says that a retailer, for example, won't carry the products at all of a manufacturer's rivals.

More generally, though, I think we can usefully divide provisions into two groups. First, a firm's contract conditions only on what it gets. For example, the firm might require a certain number of linear feet of display space or a certain number of aisle caps. In the second group, the contract conditions directly on what rivals get. We started talking about this a little bit earlier in this session.

One example, of course, is a pure exclusionary term, but other examples might include lower prices that are conditioned on the retailer achieving a certain share of category sales or the retailer providing a certain share of display space in the category to the manufacturer.

To the extent that you're paying for high market share, you're also paying to reduce the amount that your rivals are getting, because one way to have a high market share is not to give you more but to reduce what your rivals have.

I think in general we expect the first type of arrangement to be less effective at securing exclusion. For example, suppose that the first type is used, that is something that just buys a certain amount of space by a dominant firm in, say, laundry detergent. So this laundry detergent manufacturer might require that he gets a certain number of aisle caps at a certain amount of space.

In principle the rivals of this laundry detergent manufacturer then are free to, in a sense, buy space away from toilet paper or napkins. That is, there's lot of other space in the store that in principle could be reduced in order to increase the amount to these other manufacturers.

And that's why in a sense conditioning directly on what rivals are getting is much more effective at securing exclusion than is just buying a total amount of space.

Now, there are some exceptions, of course. In some cases there's special placement that's required for these rivals, so, for example, it may be a product that requires space at a checkout counter which may be very limited. If you buy that space there's no ready substitute. And yesterday we actually heard about dairy cases. You can't put your milk in, outside of a refrigerated case, and so at least in the short run that may be a constraint.

But I think actually the milk example kind of reinforces this idea of substitution because the one thing we heard yesterday was that supermarkets, because dairy products are selling a lot are trying to expand that space as fast as they can. That's really just a reflection of this idea of substitution.

So the second direction related to Steve's comments concerns what conditions permit such exclusionary practices to be successfully employed. Here Steve raised an important question which helps in guiding our thoughts. That is, why would retailers participate in creating a monopoly supplier? Answering this question I think can provide some guide to what conditions we might look for.

Steve's answer was that "preserving competition is a public good." Another way to put this is that retailers' decisions about exclusivity may in some cases have external effects on other retailers by affecting the level of competition that these other retailers face, and these effects may not be taken into account when the initial retailer agrees to an exclusivity provision. So in what kinds of situations might this be so?

Well, one example might be where economies of scale exist in production and distribution. For example, suppose you have to achieve a certain amount of sales to recover fixed costs of supply in a certain market or a certain region, and if a dominant manufacturer can secure a high enough fraction of outlets, it may not be profitable for you any more to be in the market or to consider entering the market.

That would be one example where a given retailer's decision to accept an exclusive, reduces the level of competition that other retailers are likely to face, and so that initial retailer may not worry about it, and so it may be easier for a manufacturer to be successful in this case.

Of course, another example of something like economies of scale exists on the demand side, which would be network effects. We've seen examples of that in a recent high profile antitrust proceeding.

As another example, we might have situations where reduction in available distribution curtails R&D development; that is, if you can't have distribution, maybe it's not worthwhile to develop better tortilla chips or another similar product.

Finally, a third example might be a situation involving brand loyalty, meaning shifts in share today can alter competitiveness tomorrow. For example, if I can reduce the amount of sales you have today, because of consumers tending to stick with things they have at tried and liked, maybe if I can get a high market share today, that may weaken my competitors tomorrow, and that may be a valuable thing.

Now some comments regarding these examples. The first thing is a critical issue in all of this, and that is how many outlets are really necessary for effective distribution. It depends a lot on the structure of the retail market. Is it enough to be in one or two stores, or do you really need to be in many stores in order to effectively distribute your products?

Second, even when these conditions exist, whether exclusivity arises will depend on part on the loss to the retailer due to reduced variety. It will be a balance between this loss to the retailer which would involve reduced variety, not having the profits on the product that's excluded as well as whatever effect the retailer considers reduced competition, against this gain to the manufacturer which includes both present sales and the future value of increased market power.

Generally we might expect that the less you have to buy, the fewer exclusives you really need to reduce competition. Also, as the retailer sector becomes more fragmented, the less the retailers consider this competition-reducing effect.

So I think just as an aside, merger policy enforcement at the retail level may be very good for reducing levels of charges -- reducing the cost of space per se -- but actually may go the other direction in terms of how easy it is for manufacturers to exclude rivals.

Finally, Steve mentioned the difference between short-term and long-run exclusive dealing contracts. And if you think about these examples, you'll see that the effectiveness of short-run versus long-run contracts may depend on the setting.

So, for example, in the brand loyalty case, even a series of short run contracts might be quite effective at increasing market power.

Finally two final but brief topics. I haven't mentioned efficiencies. Although I won't have time to expand on them here, I do want to note that there are a number of efficiency-based motivations for exclusive relationships, each of which has its own particular set of conditions under which it may operate.

And the final point is about the empirical evidence on exclusive contracts. A lot has been said both by Steve and myself about the theory, and that is at least moderately well developed, but empirical knowledge is really much less far along. In this regard I think it parallels our limited empirical knowledge about slotting practices, which has been discussed yesterday, and about vertical contracting practices more generally.

And I think sessions such as these as well as more scientific statistical studies are really very much needed in the area.

Thanks.

MR. BALTO: Thank you, Professor Whinston. Let me try to pick up on some of the questions that he's posed for us. By the way, at the end of this panel everybody will have a chance to add in any additional comments or pose any questions for us.

Is it the experience of the manufacturers and the producers that the trend towards consolidation is exacerbating the problem with slotting allowances? Pam

Mills?

MS. MILLS: Yes.

MR. BALTO: Does anybody have any examples along those lines?

MS. MILLS: I have an example. I don't want to say chains or anything, but we were in this one store for like 40 years, and when the consolidation happened and they had to buy the store that we were in for 40 years from another chain, basically we had to pay to stay, like new product introduction. And they're the new kids on the block, we weren't.

So that's a prime example. And the dominant manufacturer got the larger space too, and they had never been in that store, ever.

MR. BALTO: Any other examples? Scott Hannah?

MR. HANNAH: We had a similar type case where we had an item that was doing well, well being in the middle third of the velocity by a local chain, and the merger required a higher slotting allowance and/or discontinuance. We weren't up to the additional slotting at the time, so we had to walk away, lost the product.

MR. BALTO: Now, one of the questions that both Professors Whinston and Salop touched on are the costs you might incur in entering into a new market. You might not be able to enter a new product just in a relatively few stores, perhaps because of the cost of distribution or the cost of advertising, so you have to enter in a big way. Exclusivity provisions could serve as a significant impediment in that type of situation.

Do any of you have experience on this issue?

MS. MILLS: What I can say is that because of this new store that came into our market, I learned a whole new bag of tricks. Basically it kind of educated me to the new verbiage of rebates and percentage rebates, and it was just an incredible new verbiage I had never experienced before.

But bottom line is it's money in their pocket versus the manufacturers.

MR. BALTO: Besides price concerns, we're also concerned about the impact on choice or the impact on innovation. Again to the manufacturers and producers, what's the impact of slotting allowances on your incentives to innovate or your sense of product diversity in the categories that you're familiar with? Scott?

MR. HANNAH: Okay. The case scenario -- I have to admit we copied the idea from a company in the midwest, they're not in the West Coast -- was to leave some of the potato peel on the shredded hash brown, very simple. We sell a shredded hash brown that's in the top third, and the idea was to leave a little bit of potato peel on it, increase the vitamin content by triple.

It was a very minor change, but it would have required a whole new slotting allowance just to make that change in the same slot, so that's an idea where innovation is killed. The consumer loses. We lose. Everybody loses.

MR. BALTO: Pam, would you like to add to that?

MS. MILLS: I can add to that. Due to the recent resets different chains have placed us on, I had a product that I was actually developing, and I have artwork that's sitting there pending. I have a new product that I came out with, but since I'm limited to unlivable space, quote, unquote, of inches, I don't see the sense in putting the new product in. You follow the 80/20 rule. You put 20 percent of your product that gives you 80 percent of the return.

So basically you put your best foot forward, and you eliminate the choices to the consumer because I'm only limited to inches now, so I've had to take products off the marketplace, and I'm sure brand X was very happy about that.

MR. AVERITT: We've been talking so far mainly about supermarkets as the preferred outlet. Could we spend just a moment and consider alternative outlets? For example, Jack McMahon is in the line of business where evidently a lot of retailers will want to have only one supplier for greeting cards. I understood you to say earlier that they'll put that up for bid, and sometimes the bidding becomes awfully rich.

MR. MCMAHON: Right.

MR. AVERITT: If that happens, how easy or how difficult is it to find alternative outlets that are within your capital budget?

MR. MCMAHON: Well, there are a lot of new retailers coming out every day, but actually the small retailer really basically would receive no benefit. When I say no benefit, I mean no slotting allowance. The consumer does not benefit at all. Basically just the manufacturer benefits if you're not paying out any slotting allowances.

But for us to pay a slotting allowance, which we do not, it would have to be for a large chain. The small little retailer, five or six stores, would not benefit at all.

MR. AVERITT: But is this sufficient for you to remain a competitive presence in the market with these other opportunities?

MR. MCMAHON: Yes, because it's increased sales. You're always looking for increased sales certainly, but we find basically as far as the manufacturer, for slotting allowances, all we do is decrease our profits. It hasn't increased our profits. It may increase it from the standpoint of volume, yes.

MR. BALTO: What's the impact on prices?

MR. MCMAHON: Prices haven't changed. In our industry prices have been published, and they haven't changed in years, whether it's a 1.75 to 2.50 card.

MR. BALTO: Okay. Victor, to what extent is Stop & Shop sort of out there sad and lonely being the one innovative company that's seeking out small manufacturers and has a special minority advancement program? Or to what extent are there other retailers who are doing the same thing?

MR. THOMAS: There are other retailers doing it, although like I said they're probably not to the level where Stop & Shop is. We're certainly not sad about that. It puts us at a slight advantage. But again there are other retailers, and I think that retailers are becoming a lot more savvy, a lot more progressive and a lot smarter about doing business. I would hope that they would start to recognize that very quickly.

The demographics are changing so that they are going to have to.

MR. BALTO: Burt, you've been sitting there patiently.

MR. FLICKINGER: Yes, I would just like to thank you. I would like to complement what Victor Thomas and Professor Whinston said, that the chains that are inclusionary, as Professor Whinston said, have a strong competitive advantage. If you look at the chains with the highest dollars per square foot and the highest sales per store, specifically Pathmark, Stop & Shop, and H.E. Butt Company in Texas, they have the greatest amount of variety.

And if you look at the supermarket chains, they're now facing seven major channels to the consumer Neil's point is that there are many alternate forms of distribution, 24 hour food and pharmacy for all five major drug chains, that's new. Convenience stores are now convenience supermarkets.

Super Centers are new. Mass merchants, 40 percent of what they sell are items sold in supermarkets. Club stores, 60 to 65 percent of what they sell are items sold in supermarkets. Hard discounters, Aldy and Save-a-Lot and the supermarkets, accommodate the small suppliers and have increased the size of their store from 20,000 square feet on the average 25 years ago to today 35,000 square feet because there are 25,000 new items being introduced today versus one to two thousand 25 years ago. So they're taking on all the small suppliers, adding more variety to Professor Whinston's point about being exclusionary.

And in addition to that, there's the all other markets. Suppliers have tremendous opportunities. To Tom's point, we're not talking about the growing season. Mayor Brothers in Orchard Park, New York, a small apple grower, worked with Topps and the other major supermarket chains from cider to apple juice to bottled water, a category which now has 400 SKUs, highly competitive, but lots of opportunities.

Thank you.

MR. BALTO: Thanks.

MR. COHEN: One question for Professor Whinston. In your work on exclusive dealing, I would like to try to focus you on what you've done in thinking about anti-competitive effects. In particular situations it's pretty easy to determine an anti-competitive effect. They're difficult in their own right, but if it's price, we're familiar with dealing with that. But what if our concern is with variety and the exclusion's effect is to remove from the market one of the possible sources of variety?

How would you go about getting a handle on when this rises to the level of competitive concern?

MR. WHINSTON: I think it's a tough question. I agree about your comment about price. It isn't always the case that price rises. Take one example unrelated to the present case, like pharmaceuticals. When a generic comes in, often the branded price actually goes up. Suppose a pharmaceutical manufacturer could keep the generic out, it might actually price lower because it wasn't going to price to a small segment of the market anymore. It was going to price to everyone that was there.

But nonetheless we think keeping the generic entry is very important for welfare in a generalized sense because we're losing variety -- the variety being a low price in the case of a generic, variety in a sense of people who don't care as much about a brand name.

So I think it is a significant concern. In principle, we know how to measure welfare effects. The difficulty is actually considering what is the welfare loss from the loss of variety, and in distinguishing that from efficiency reasons that exclusives may be used.

MR. BALTO: Kevin Hade?

MR. HADE: We were talking about the role of helping small manufacturers, just to tag on to what

Victor was saying. It strikes me -- representing a retailer here today and listening to the plight of some of the manufacturers that are represented here at the table -- I think one of the things that's happening in our industry today is that you're seeing the shrinking basically of the independent retailer.

And I think for many years this was an industry where you had a lot of businesses that were regionally-based, that connected with small manufacturer, and I think the partnerships were there. In the case of what Stop & Shop is doing, I think that's unfortunately not the majority opinion of the major chains today.

I think they're an exception to the rule and again should be applauded for it, but if you look across this country, I think a majority of your independent grocers work overtime to help the small manufacturer get on the shelf because again our life blood is diversity of product, bringing choices to the market so that we can compete on variety against large chains.

And I think an issue that the Commission should consider is the impact the shrinking base of the independent may be causing -- it may be causing some pressure in this area.

MR. BALTO: We'll certainly get to that in the next panel. Pam Mills, why don't we give you the chance to make the last comment.

MS. MILLS: I just wanted to comment on product choices and the smaller manufacturer. Probably about a year ago, one of our chain stores, for whatever reason, I guess it was their business plan, but they deleted from their system over 20 tortilla companies. These are smaller companies that probably can service only maybe five stores in the particular area where they're located. This only proves to me that the shelf space is so valuable for the slotting fee money that they were in the way.

MR. BALTO: Even though we've run over, the manufacturers have traveled out here at great expense to themselves. If any of you have any final remarks you would like to make or any things you think we should consider, please do. Karen?

MS. CARVER: I just have one comment. The small manufacturer actually is facing two opposing sides in the marketplace. You have the large retailer who is benefitting not only from us being a small manufacturer, but the big manufacturer also reaping the benefits of being able to offer those large exclusive payments up front that we can't do.

So the small manufacturer only has the option of going to the smaller companies to do business with, so they can get their foot in the door. In some of your larger metropolitan areas there are no small grocery chains, so you are kind of left with the mom and pops. I just think that we have a person on both sides that we're fighting.

MR. BALTO: Well, thank you very much to the members of this panel. We've spoken with many people on both sides of the issue, generally representing small manufacturers and large and small retailers. We've been eternally grateful over the past several months that they were so willing to give us their time, and I'm very thankful to the people on this panel who came out and participated.

We will convene together at 10:20.

(A brief recess was taken.)

PANEL 3: POTENTIAL EFFECTS OF SLOTTING ALLOWANCES, CONCERNS OVER PRICE, CHOICE, AND INNOVATION

PANEL 3 MODERATORS

DAVID BALTO, FTC
MOLLY BOAST, FTC
NEIL AVERITT, FTC

PANEL 3 GUESTS

DON SUSSMAN (Ahold)
SCOTT HANNAH (Pacific Valley Foods)
JAY CAMPBELL (Associated Grocers)
RICH WARREN-BOULTON (Economist)
PETER DE LA CRUZ (Attorney)
TOM STENZEL (UFFVA)
AKSHAY RAO (University of Minnesota)
BOB HOUCK (CoAMS)
NICK PYLE (IBA)
BOB REYNOLDS (Consultant)
GREG SHAFFER (Economist)
GREG GUNDLACH (Marketing academic)
IRWIN STEINBERG (Tortilla Industry Association)
WINSTON WEBER (Consultant)

PANEL 3 GUESTS (Continued)

JOHN EAGAN (Costco)
J. MARK GIDLEY (Attorney)
PIERRE TADA (Limoneira Company)

MR. BALTO: We're beginning the third panel, the discussion which is going to deal with the issue of market structure, the potential for buyer power and the impact of slotting allowances on price, choice and innovation. We're primarily focusing, though, on the issue of whether retailers have buyer power.

Let me just say as an overview, for the non-antitrust attorneys in the audience, that there are volumes of antitrust works that are published on the issue of how power by sellers leads to anti-competitive effects, where that's monopoly power collusion by sellers. But there's a relatively much more discrete and limited amount of volumes published on the issue of monopsony power, the exercise of power by buyers.

Why is that? Well, Justice Breyer once said in an important case that the authors of the Sherman Act were primarily concerned that consumers receive the benefits of low prices. He instructed therefore that Courts should be hesitant, in fact very reluctant to act before they try to limit the ability of buyers to extract lower prices.

The panel today is going to deal with that issue of the potential of anti-competitive effects on the buyer side, an area that's not necessarily new, but where there's relatively less experience in the area of antitrust.

Let me again have us introduce ourselves in counterclockwise order beginning with Irwin Steinberg. Please identify yourself for the reporter and state what organization you're with.

MR. STEINBERG: My name is Irwin Steinberg. I'm a business consultant and the executive director of the Tortilla Industry Association.

MR. WARREN-BOULTON: My name is Rick Warren-Boulton. I'm an economist. I think we're reaching critical mass of boring economists, and I'm with MICRA, which is a Washington based antitrust consulting litigation operation.

MR. SHAFFER: My name is Greg Shaffer. I'm at the William E. Simon Graduate School of Business University of Rochester, and I'm another economist. I'm also a marketing person.

MR. EAGAN: John Eagan, Costco Wholesale, the vice president and general merchandise manager in Los Angeles.

MR. CAMPBELL: Jay H. Campbell with Associated Grocers in Baton Rouge. It's a retailer-owned grocery wholesaler.

MR. PYLE: Good morning, Nick Pyle with the Independent Bakers Association.

MR. DE LA CRUZ: Peter De La Cruz with Keller & Heckman.

MR. REYNOLDS: I'm Bob Reynolds, Reynolds Associates, food industry consultants.

MR. GUNDLACH: Greg Gundlach, professor of marketing Mendoza College of Business at University of Notre Dame.

MR. HANNAH: Scott Hannah, CEO of Pacific Valley Foods, Bellevue Washington.

MR. RAO: I'm Akshay Rao. I'm at the Carlson School of Management, University of Minnesota. I used to be an economist. Then I saw the light. Now I'm a professor of marketing.

MR. HOUCK: My name is Bob Houck. I'm with CoAMS. We manage and consult on trade advertising programs.

MR. TADA: Pierre Tada. I'm the Chief Executive Officer of Limoneira Company. We are a grower-packer-shipper of agriculture, and are also involved in frozen food processing.

MR. GIDLEY: Good morning. Mark Gidley with White & Case, Washington, D.C.

MR. WEBER: Win Weber, president Winston Weber & Associates. We consult with manufacturers and retailers.

MS. BOAST: I'm Molly Boast from the Federal Trade Commission.

MR. BALTO: I'm David Balto from the Federal Trade Commission, and sitting next to me is Neil Averitt. Don Sussman has just sat at the end of the table. He's with Ahold.

Again the ground rules are if you want to be recognized, you lift up your name card in a vertical fashion, and I will call on you. We have just about an hour and a half to go through today's topic, so let's try to keep our answers short and to the point.

Let's start off with a general question. Are slotting allowances a manifestation of retailer market power, and should the FTC be concerned about that as a problem? Peter?

MR. DE LA CRUZ: Thanks. I'm a secret witness since I don't have a card.

I think that the first two roundtables have really shown that we have a very rich and diverse industry, but I think based on the A.C. Neilson studies and some other written work, we're beginning to see that slotting allowances are becoming more common, and the costs are increasing.

And to the extent that those increases don't reflect merely a transfer of cost from the retailer to the manufacturer, then there's something else afoot that would tend to increase this.

One of the things that I think was kind of interesting is that it appears that the companies are striving to be the low cost providers and apparently tend not to charge slotting allowances. One would I think from the manufacturer testimony assume that the cost passed to the manufacturer raises their cost, so ultimately I think that it may have an adverse effect on consumer prices.

Although I think in fairness, we shall acknowledge the difficulties that makes the analysis complex. Yesterday there was reference to a competitor with Super Centers. I think if there is a competitive price driver, the question is whether greater efficiencies actually could be realized across the broader marketplace without the use of slotting allowances generally, and whether there's a transfer going on here that really is counter-competitive.

MR. BALTO: Win Weber?

MR. WEBER: I do not believe the FTC should be concerned about slotting allowances for a number of reasons. First of all, let's look at the influencing factor of buying power, however we wish to define buying power. Size is an influencing factor whether it's on the retailer side or supplier side.

We're talking brand loyalty or the lack of brand loyalty -- that is an influencing factor. We've talking about consumer demand, either existing consumer demand or future consumer demand, and we're talking about information or lack thereof or the availability thereof.

Those are all factors that influence the decision of a retailer -- who is a retailer who's going to be in business tomorrow -- because what we're really dealing with is the power of the consumer. Over 60 percent of all consumers today carry loyalty cards. That information is now accessible to the retailer. Retailers did not have this ten years ago.

The retailer today knows more about their customer than they ever have -- the buying behaviors of the customers, which one are their most loyal, which ones are their most profitable. I could build a very strong argument to suggest that with this power of information, the retailer today is more sensitive to the consumer, and future decisions will be geared more towards consumer needs than what slotting allowances can or cannot offer.

And therefore I think that the slotting allowance issue is relatively insignificant as it relates to how we're going to be serving consumers in the future.

MR. BALTO: Mark Gidley, you're sort of familiar with what we do on supermarket mergers. Should we be concerned with market power on the buyer side when we look at supermarket mergers?

MR. GIDLEY: Well, I think that one of the things that you've got to understand is the context in which supermarkets operate today. Today we face enormous cross channel competition from Wal-Mart Super Centers. Let me be specific about that.

We're blessed with the best economy in 30 years, I'm told every time I read the newspaper, and I believe it based on my experience on this planet. No unemployment, no inflation, no food inflation, and about 6 percent GDP growth.

Despite that, in the last year Jitney-Jungle, Bruno's and Schwegmann's have all declared bankruptcy. Now, these weren't some kind of fly by night supermarket chains that lost track of where they needed to be with a customer. These are the kinds of chains that have kind of a Stop & Shop loyalty.

They sponsored Little League teams. They were around for 50 or 60 years. They were institutions. It would be like Hechinger's here in Washington. They're gone or they're now in Chapter 11 and getting reorganized.

So we've heard a lot about what the manufacturers are going through, and I believe that many of them are cut on the scissors of trying to get their costs down, but so are the retailers. The retailers live in a world of 1 to 2 percent net margins, and if you compare that to the publicly traded manufacturers, the margins of the publicly traded manufacturers tend to be higher.

I'm not here to say that any one manufacturer has got too high a margin or that it's time to break up Wal-Mart, but I'm here to say that as Wal-Mart rolls out Super Centers across the country and moves from 180 billion in sales to 250 billion in sales, the question of slotting fees will become somewhat academic.

MR. BALTO: Scott Hannah?

MR. HANNAH: Thank you. I'm going to have to make a couple strong counterpoints here. I can't let this rest, Mr. Weber.

I'm going to go back to the first comment. Let's put this to bed right now about this net profit. Argue with me if you think I'm wrong. I've heard this before. The poor supermarkets only make 1 or 2 percent net profit. Manufacturers make 4 percent. It's like so what. It's the return on investment that measures this economy in the United States, and the return on investment is identical, so let's stop whining, please.

The second comment is the FTC should be involved in slotting allowances, Mr. Weber. It is anti-consumer. It is anti-small-business. It is in definite violation of the Robinson-Patman Act. I'm not a lawyer, but it's easy to read the act. It's easy to interpret.

There's no way these slotting allowances do not harm consumers, and they harm small business. Definitely the FTC should be involved.

Thank you.

MR. BALTO: Thank you. Thank you, Scott. Can I have a show of hands of attorneys in the audience who think that the Robinson-Patman Act is easy to interpret? (Laughter.)

Thank you. Scott, you're absolutely on the mark for 90 percent of the things you say. Win, would you like to respond?

MR. WEBER: Is this point counterpoint? We should get paid for this.

One thing that has frankly bothered me over the last two days is just the basic relationship between a buyer and a seller. As we look at that basic relationship, and as I listen to our retailer clients and I look at the side of our manufacturer clients, number 1, a buyer is going to look at the quality of the product.

The buyer has specifications. Whether you're a food buyer or an HBC buyer, whether you're buying cars, there are specifications for quality, uniqueness, consumer demand, service, support. There's no need for a retailer to buy a product if there is not a point of differentiation that brings value to the retailer's proposition to the consumer.

If in fact there is a value proposition there is a point of differentiation, and if slotting allowance get in the way of moving that product forward, I would agree there is a business problem in that situation. Unfortunately, if there's a small percentage of retailers who there are making decisions more on slotting allowance than they are on what's best for the consumer, so be it. It's a shame because that behavior should not be tolerated in the industry.

On the other hand, from a supplier standpoint I have no sympathy for suppliers who are just trying to put products in the marketplace that are me-too. You have the cost of replacement, the cost of duplication, and I think we're dealing with an issue here that has a responsibility on both sides of the buyer's desk. So let's think of that basic buyer equation.

Retailers are not just going to buy a product for the sake of putting it in.

MR. BALTO: I want to add to that by bringing in a couple producer's points of view, Pierre Tada and Irwin Steinberg.

MR. TADA: Well, first of all, I keep hearing the focus on new product introduction. The majority of the products my industry produces have been around for a long time.

MR. BALTO: Like tomatoes and cucumbers?

MR. TADA: And oranges and lemons and watermelon and you name it, so every time we hear about the new production introduction side I'm a little confused. We're talking about charging and extracting monies from products that have been around a long time. Well, gee, is a watermelon going to sell in the summertime this time around? I think we all kind of know the answer to that.

So I would like to focus on the fact that we're really dealing with a lot of mature products. What are the behaviors going along with dealing with mature products? As I mentioned in the last panel, the product that we produce, we sell it or we smell it. And as the power in one end of the channel continues to grow, there's one thing that is well known. If you don't get the sale today, the product probably doesn't exist a week down the road, so there's a tremendous amount of power leveraged back against the agricultural producer.

We looked at this very high profile antitrust case with Microsoft, and most of that was dealing with conduct and how conduct manifested itself in the marketplace. This is what I think we're really talking about: What is the conduct and how is it impacting competition?

I think the upshot of it is the majority of the folks in my industry, fresh produce, are small mom and pop operations. There's some larger operations. Even the larger operations pale in size comparison to what we're talking about. We have a very strong belief that we have to deliver on quality. We have to deliver on all the things that the consumer needs. That is a given.

What is not a given is an up-front extraction of monies not related to performance, not related to what is really going on, and that's the part we would like to further explore. We don't think it really helps on the consumer price side. It adds cost. You add cost, in the long run we feel it's going to add to consumer prices.

MR. BALTO: Irwin Steinberg?

MR. STEINBERG: Yes. Well, I would like to take great exception to Mr. Weber's comments as well. I think he's living in a fantasy world.

MR. WEBER: The fact is that I was called an alien this morning.

MR. STEINBERG: Same thing goes here. Let's exclude Stop & Shop and some of the good retailers who are at this table and around the country. There's a vast number of supermarket chains, mostly the larger ones, where the buyer's total obligation is to sales per square foot, not to the consumer and not to the quality of the product that he puts on the shelf.

And because of that, there has been, at least in the tortilla industry, definite exclusion of suppliers who cannot afford to come in with the right product.

We did a little survey before I came out here, and I want to give you the remarks of two of our member companies, and we represent most of the tortilla companies in the United States. One a small company in San Antonio. We asked, Do you pay slotting allowances and if so, how much do you spend?

And one answer came, We spend none because all local tortilla factories were discontinued by all supermarkets because one company agreed to pay between $12 to $15,000 per store for exclusive shelf space. That was Texas.

The second comment comes from a small company in Oxnard, California, which says, We have not been given the opportunity to pay for slotting allowances. This is not to say that we would be happy or willing to pay if asked. We, along with other suppliers, were just told not to leave any DSD product anymore, that only one supplier would stay. This was totally unexpected for us since we outsold the supplier that stayed. We lost all supermarkets and five warehouse clubs.

If in fact the mission of the Federal Trade Commission is to determine whether exclusionary practices are violations of the antitrust laws, then forget all about this other fantasy. There are retailers who are doing it, and there are retailers who are not doing it, and it's very clear at least from the tortilla business that they are.

I want to tell you a story, too, without regard to some of the members of the panel. There were two men in a hot air balloon -- I told this story to two people yesterday -- who came landing very hard on the ground in an unknown area because the hot air went out. A gentleman walked by, and one of the men in the balloon said to the gentleman, Where are we, and the gentleman said, You're in a hot air balloon. And this man in the balloon turned to his friend and he said, Just our luck, we have to land accidentally and meet an economist. And his friend said, Why is he an economist do you think? He says, Because when you ask him a question he gives you a perfectly sound answer that is totally worthless.

MR. BALTO: Even though Jay Campbell is the next person to have his hand up, I'm going to go out of order and let the two economists reply now, so why don't we start with Greg Shaffer and then to Rick Warren-Boulton.

MR. SHAFFER: Instead of providing an answer I wanted to ask a question, so I think I'm immune from this criticism at least in this comment.

May I ask a question on something that was said one comment earlier? The gentleman at the end -- many of the efficiency stories for slotting allowances pertain to new products, so I think it's important that we distinguish between payments that are made to get new products on the shelf, versus payments that established firms pay. One thing that you're saying is that they do exist, payments to keep established products on the shelf. Like the watermelon is not a new product.

Yesterday what I was hearing was that it's not very common, and they were called pay-to-stay fees. I was wondering just for the terminology point of view, what are these payments called? Do you use a different term than pay-to-stay?

Could that possibly explain why I hear some retailers saying, No, we don't ask for pay-to-stay fees, and I say you saying, Yes, you do pay them? I think this is an important question. It could be a terminology difference.

MR. TADA: It's kind of like asking what is the definition of sex, and we do you mean by --

MR. SHAFFER: Are you talking about lump sum payments, wholesale price discounts?

MR. TADA: Lump sum payments up front, arbitrary, not tied to cost, and it's for the privilege of continuing to do business, and this is not on new products. It's on existing products, and it exists.

MR. BALTO: And it's a payment?

MR. TADA: It's a payment.

MR. BALTO: I'm going to stick with the manufacturer's side. We will get to the retailer side. Nick Pyle?

MR. PYLE: Well, I'm going to echo a lot of the comments I've heard anti slotting fees. Our members feel very strongly about the FTC getting involved. We've looked at litigating, and it would cost a half million dollars. It goes to the issue of a fundamental shift.

There is market power. We've brushed briefly on buyer income. We've touched on that, and conduct, and conduct is critical because these are secretive payments, and we need a little sunshine, and that's why we want the FTC involved. These things are not tied to volume or price.

I think that's a good way to delineate what a slotting fee is, an entry fee. Now we're talking about pay to say. Pay to stay can be a warehouse fee. It can be an SKU charge. It can be the ubiquitous computer charge related to the takeover of a chain. They come hidden in all different ways.

MR. BALTO: Let me just ask, let me pose a problem we've struggled with. We've tried throughout our interviews with the 80 manufacturers and retailers to figure out who had power, and it seems in some respects arguments could be made on both sides.

From the manufacturers side they could be saying, We really have to be in every store, being excluded from any individual store would be so significant, we don't have a choice, we just have to be there.

On the other hand the supermarkets may claim that they are the people who have less power because when a consumer walks into their store, they don't expect to see just one brand of detergent or one brand of crackers. They want to see everything. They want to see a full variety of crackers.

So what's the answer here for these people who are in the market? Who is it that has power, and what's the kind of power relationship between manufacturers and retailers and how has it changed?

MR. PYLE: That relationship has changed a lot since the 1960s when the supermarket owners came to manufacturers and said, Give us things to fill the shelves. Now the relationship has changed where the buyer or the retailer is no longer a reseller of goods but is essentially morphed into a renter of shelf space.

MR. BALTO: Don Sussman?

MR. SUSSMAN: It's very much a mixed bag when it comes to power. It goes vendor by vendor, store by store. Yes, we ask for slotting fees for new products in most of our categories. When Starbucks coffee comes out in the supermarket, 12 SKUs, supermarket ready coffee, whole bean and ready ground and doesn't offer slotting fees, and we have a choice of either not taking it or taking it. We took it because we knew our customers wanted it, and it would sell. It was well supported. The brand was well known, and it was either have something that our customers wanted or not have it, so we took it without the slotting. In that situation I would say that Starbucks certainly has the power to impose their brand.

In other categories and other products it's not true, so it really depends. It's very much a case by case situation.

MR. BALTO: Jay Campbell, would you like to address this?

MR. CAMPBELL: I would like to dovetail it into your other question as well. You started by asking the question, Is slotting a manifestation of marketing power and should the government be involved? Now you have asked a question about, Has the market changed? Is there a new dynamic out there?

I think the answer is very clearly, we have seen a dramatic change in the landscape of the retail competition in the grocery industry over the last 25 years, and it has been caused by a variety of things. Number 1, it's a change in the consumer. It's a more demanding consumer, a more informed consumer.

We have also seen, particularly in the last 10 to 12 years, considerable activity in the merger and acquisition area. The merger and acquisition area has proliferated in our grocery business, and you have to stand back and wonder and question why that has occurred.

I would like to digress a moment. I've heard many comments made throughout this panel, not only this morning but even yesterday, that "I don't have access to the shelf." Well, there is no guarantee that anyone has access to the shelf. I think you have to earn your access to the shelf, not just through a payment necessarily, but through the consumer.

And it doesn't mean you get to go to the top chain in the country and have a guarantee to put your product on the shelf. You may have to start in a simpler mode to get there. There are no guarantees of success in business nor of any product or any competitor.

The question we have to ask is, Should the government even be involved in price, choice or innovation? I think you started, David, with your comment earlier this morning about how we want to see price, choice and innovation. Is that a governmental issue? I don't think it is a governmental issue.

I think that's a competitor issue. I think that's one of the reasons people are successful in the competitive marketplace is because they offer price, they offer choice, and they offer innovation to the consumer.

Let's go back to the merger and acquisition activity. One of the thing that Senator Bond said in his tape is that we're looking to see that we have enforcement properly of the antitrust acts the Sherman Act, the Clayton Act and the Robinson-Patman act.

What has happened in our marketplace? Why have we seen mega-buyers, power buyers occur? Could it be that we have a sequence of events that have taken place over these years where we haven't seen enforcement ensuring that all competitors in the marketplace have adequate disclosure or the permanent information they need to be a buyer and to be a seller in the marketplace?

And that would relate to products available, to pricing available, to packaging, to promotions -- and you can wrap slotting into promotions -- to pricing, and to payment terms. If those things are consistently supplied and offered to all competitors fairly and equitably in the marketplace and enforced properly, I don't think you would have seen the merger and acquisition activity that you have today and the rush to size.

Earlier the gentleman at the end of the table talked about Jitney-Jungle, Bruno's and Schwegmann, all in the south, right in my backyard. Jitney expanded through a leveraged buyout and bought Delchamps, went into debt to get bigger. Bruno's did a leveraged buyout to buy themselves out and buy more storage to get bigger. Schwegmann's bought National Tea in New Orleans to get bigger. The goal was to get bigger, to get clout, to get power and influence as it relates to the manufacturer community that they dealt with.

As we have seen the growth of mass discounters get larger, we have also seen the growth of major chains, in an effort to get larger for this level of preference that they feel that they can achieve.

My concern has never been with slotting allowances. If they're available equitably and fairly to each and all competitors in the marketplace, that is fine. If you are a small manufacturer, you may have to start out small. You may have to start with us poor independents or with the specialty stores or the gourmet stores or something else to get your product recognized because there is no right of recognition.

If I have an innovative product in my pocket right now I have no right to go to the largest chain and say, You must take it. I must prove it in the marketplace of public opinion with the consumer.

So I think what we need to do is narrow down the reality that the government shouldn't be involved in running our businesses. The government should be involved in ensuring that the playing field that we're on is fair for everybody to compete, and the consumer will make the choice for us on our products and the way we run our operations.

Thanks.

MR. BALTO: Thank you. We'll pick on some of those things a little later. I want to go back to my question, and I think Bob Reynolds was going to reply to it, about how do we look at the question of power between retailers and manufacturers.

MR. REYNOLDS: I think that one of the things that's been on my mind yesterday afternoon and this morning is that the manufacturers that we've heard from are relatively small and have relatively weak brand or fungible brand kinds of issues, and we have not really heard the point of view from the large-brand sellers.

I'm sure they weren't excluded from being here today, so I'm not suggesting that that's the case. However, one of the key differences between the no brand or the fungible brands, versus the large brands, is the amount of pre-selling that happens with these kind of things.

That comes to the marketing equation before the products ever get to the store. Are they pre sold? In the Starbucks environment that Mr. Sussman gave us down here, it was a situation almost of a must-carry for Stop & Shop, and they couldn't charge a slotting fee in that regard.

So it's really important, when we're looking at that power equation, that we keep that kind of issue in mind, as to the participation of the brand sellers in the marketing process.

One of the things with fungible brands is that they depend upon access to consumers in the stores as their primary means of communication with a consumer. You may have cents-off, but that again is probably a point of sale. I think that's a really important issue to understand when you start to try to pick apart the power equation and differentiate well marketed national brands versus fungible brands insofar as the retailer is concerned.

MS. BOAST: Can I ask a question? One of the things that it seemed to me was implied in Mr. Weber's earlier comments about information and loyalty cards is that with increasing information bases, consumer choices can be better predicted.

MR. WEBER: Yes.

MS. BOAST: Does anyone believe that this would lead to the demise of slotting allowances and render them unnecessary? And if so, are there any implications for market power analysis?

MR. REYNOLDS: Let me just respond to that quickly. The information is terribly important to the retailer power issue. The primary swing between manufacturers and retailers over the past 15 years or so is that the retailers control the most available sources of information.

That's the information that comes off the scanner, and whether in fact that impinges on whether there's slotting allowances or not would have more to do with how effective the retailer is at marketing products in the store.

The in-store marketing program has become very, very important in this regard. To gain access to those programs, whether it's a, quote, slotting allowance or whether it's some sort of a buy-in to a retailer program -- a club card program, a coupon book program or whatever it may be -- all of these marketing funds are pretty much fungible with one another. It doesn't really make much difference how the money has come to the retailer.

MR. BALTO: Rick Warren-Boulton, did you have an answer to the question we're dealing with right now?

MR. WARREN-BOULTON: I have got a number of questions. One is where there are other good jokes about hot air for attorneys. I didn't know there were a lot of hot air jokes for industry associations, but I'll think of one.

I think, going back to the question you originally raised, which I think we should want to address is this: Is there sort of a problem here, some sense of monopsony power on the part of supermarkets? Are slotting allowances somehow a manifestation of that monopsony power, and if so should the FTC or somebody be doing something about it?

I think to begin with in all this discussion, it's really crucial that people separate out whether they're talking about new products or established products, and I think everybody would agree here. All the efficiency defenses that I've heard over the last day from the panels have to do with the introduction of new products.

Now, that being said it's also true that to an economist, it's a barrier to entry in the sense that it's something which a new entrant has to pay that an established firm doesn't have to pay. So, strictly speaking, for those of you who are antitrust aficionados, it would qualify as a barrier to entry, but it's an unavoidable barrier to entry.

And I think, given the number of efficiency defenses for this, the chance that the FTC wants to get into the business of trying to do something about slotting allowances for new products strikes me as having such a high false positive rate.

So I think two things. One is I think we should be concerned only about slotting allowances for established products, and secondly, in terms of this discussion, I think people should almost identify which ones they're talking about because there's a "ships in the night" sort of element in this discussion that goes on.

So my comments have to do with monopsony power with respect to established products, and I think the thing to begin with here for an economist is something which we all know. That is that you're talking about a situation in which it costs something for a customer to visit a store.

Very few customers I know visit more than one supermarket. Some of them go to Costco or Price Club and then will go to a supermarket, but I don't know anybody who visits two supermarkets sequentially. So what happens is that for producers of a differentiated product, they're kind of stuck in a sense that people aren't going to move because of what the supermarket does.

If David comes up with a new product, Balto Baked Beans, and decides to sell this product, his problem is is the only way to reach me as a customer is to get his product at a Safeway down on Wisconsin Avenue. Otherwise he doesn't get to me at all, and if he's selling a differentiated product rather than a homogenous product, that means that that supermarket is a gatekeeper.

There's no other way to sell to me, and a sale that's not made to me is a sale that's lost. You cannot make it up by selling it to somebody else. So even if supermarkets are completely competitive, they still have a gatekeeper role here. But I don't think you want to confuse that with monopsony power. Monopsony power to an economist is an incentive to reduce your purchases in order to drive the price down, and that's why it reduces welfare.

That's not what economists think of the way supermarkets operate. We think of them as competing for customers on a bundle or an index basis. I decide which supermarket to go to, not on the basis of their individual prices, but on what I think the cost of the bundle that I'm going to buy there is, and supermarkets have an incentive to mark up prices, products differently, and this is very frustrating for a lot of manufacturers.

You manufacture pepper and demand is very inelastic. Your problem is your supermarket insists on marking up your product by some enormous rate and reducing your sales, and slotting allowances are very frustrating because slotting allowances give them even more of an incentive to do that.

You would rather give the supermarket a low price and no slotting allowance. You give them a slotting allowance, you have to give them a higher average or marginal price, and the result is they mark up your product even more so it drives you nuts, and that's quite understandable.

But that's sort of efficient pricing by supermarkets. While I'm sympathetic, there isn't too much you can do about it. So what do you worry about?

The only thing that I've heard in the last couple of days you want to worry about is a situation in which a supermarket may have an incentive to use this gatekeeper role to the detriment of consumers. The only good examples that are floating around are situations in which a dominant manufacturer essentially bribes, pays off, or makes a supermarket a deal, an offer they can't refuse, that is going to either increase the cost to their rival manufacturers or reduce the amount that the supermarket is willing to pay for those rivals.

And those are real stories, and I know a large number of them, but they're small, and by now, as Mike Whinston I think would agree, we probably pretty well know the things to look for to find those stories.

You know, there's situations in which the entrant would supply only part of the requirement for a particular store. They can't compete on an all or nothing basis and what the slotting allowances do is put the competition on an all or nothing basis. So that's a narrow set of circumstances in which you may want to do something, but it's not classic monopsony power by supermarkets.

MR. BALTO: Thanks. That's good. By the way, for these people interested in the gatekeeper concept, Daniel Savrin in our expert panel will be speaking about that concept later on this morning.

John Eagan, I see you wanted make some comments?

MR. EAGAN: Yes, on buying power. In my experience over the last 30 years, there has been a shift from the manufacturer to the buyer as far as who holds the clout, but it really is differentiated between the size of the manufacturer and the size of the retailer.

One of the largest package goods manufacturers in the country was very hard to do business with five, six years ago. I think they've changed now, where they have involved more of the retailer partners in the marketplace, not because they wanted to give up this clout, but the reality of it was that the retailers had the information better, and they had a better track on the business that they were doing. And also they were big buyers, they were volume buyers. And they became more important, so there's a difference.

There's probably a balance of power. When it comes to small manufacturers, the retailer probably has all of the power. If it's not wielded responsibly, you could hurt yourself and the manufacturer, and you don't want any things like that to happen. I mean, you take a bigger responsibility with the small manufacturers than you do with one of the majors.

MR. BALTO: By the way, can I ask the retailers, one of the questions that Salop answered yesterday that we always struggle with as antitrust attorneys is, Why would you want to enter into an exclusive arrangement with a manufacturer, especially a dominant manufacturer? Don't you want to keep options available?

Is that something you think about? Is that the right question we are asking? Don Sussman?

MR. SUSSMAN: Well, obviously we like to have competitors for our business. We want people to be very anxious to do business with us. We think in the long run that's good. There are times, though, when you don't need multiple items, and there's a big difference between duplication and variety.

We're not in the duplication business. Items are really fungible to the customer. We're not really giving them choices by having more and more brands out there that are less efficient. If you look at our dry shelves, we have to have a case and a half of every product out there to be efficient. You can't put a new case up until you've got the old case off, and you don't want to run out of stock.

It's much more efficient to have fewer items on the shelf than have more items. Everyone knows that, so the issue is, Where do you need more than one vendor, and where is it less efficient to have more than one vendor? Do we need more than one sugar vendor? I think not in most cases. In most cases we have a national brand, then a private label, because sugar is sugar, and we don't need five of them, and it's more efficient to ship full pallets of sugar to the store than it is to be shipping half pallets and breaking down pallets in our warehouses.

So there are times when it just doesn't make sense to devote this space and the inefficiencies to have more than one supplier on an item. We basically have one line on cake decorating. It's not that big a deal for us. It doesn't make sense to devote twice as much space and to have -- instead of having a hundred items of cake decorating having 200 so we can have two different people on the shelf. So we have to make choices.

MR. BALTO: Well, let me ask a different question. But first, did any of the other retailers want to add to that?

MR. STEINBERG: Can I ask Don a question?

MR. BALTO: Sure.

MR. STEINBERG: Don, I understand the rationale of having one private label sugar and one national brand sugar. Does the national brand sugar company pay a slotting fee to you?

MR. SUSSMAN: They might have paid one way back when, when they were a new item. I wasn't around then. Sugar has been around a long time. We only take it on new items.

MR. STEINBERG: Do they do it annually?

MR. SUSSMAN: No, they do not.

MR. STEINBERG: Thank you.

MS. BOAST: Does the national brand manufacturer supply the sugar for the private label?

MR. SUSSMAN: In some cases, not all. In some cases.

MR. BALTO: Let me pretend I'm not an antitrust attorney, but I'm just a consumer. If a chain merges with another chain, and it gets bigger and it can purchase more, it has more clout. My initial response is it's going to have more clout with the manufacturer. It's going to negotiate a lower price.

Fortunately we have these people at the FTC who make sure that the retailer market stays competitive, so ultimately if the retailer gets a lower price, I'm going to get a lower price too.

Peter De La Cruz, what's wrong with that scenario?

MR. DE LA CRUZ: Well, you're assuming perfect cost pass through, and I think from even the discussion we've had in the prior two panels, that it isn't clear that slotting fees or other types of fees get converted into lower consumer prices.

It's been a very nice discussion, we almost need the big chart on the wall here because I think if you're looking at this from purely an efficiency point of view, why even have two kinds of sugar? Why not have one brand of flour, one brand of sugar, one brand of coffee?

Then you're going to decrease it, and really what you're doing is you're trying to guess on a consumer dynamic, and what's necessary for your consumer dynamic, and you're actually reducing your efficiencies to be successful in this particular marketplace.

And so they're -- well, anyway, sorry, getting off the point there.

MR. BALTO: That's fine.

MR. REYNOLDS: Just to follow up on that, in some outlets we are in a one-brand kind of a situation. Costco I would suggest is probably offering one brand of sugar, and most retailers will offer one brand of corn starch. So what's so worrisome about this?

It is how the retailer chooses to do business, and if they choose to do business in an inappropriate way, they're going to be out of business because the consumers have lots of alternatives in almost every case.

MR. BALTO: Do any of other manufacturers or any of the consultants have a view about the question I posed to Peter De La Cruz? Scott Hannah?

MR. HANNAH: We're missing a little collateral point here. I'll give you a true case scenario. It's the best thing to understand. A very, very large box chain, not Costco, recently put up for bid a continuation of the vegetable supply program, and a company that had that business from day one, and the bidding went from 4 million, 5 million, 6 million, 7 million.

The existing party finally put up $9 million to stay. Everybody drops out. Small guys drop out. The biggest company comes along and says, We'll pay you $11 million to stay, true case scenario. They got the business. The other guy was kicked out. Is that monopolistic? You bet it is.

MR. BALTO: A couple things here, Scott. First, what do you think the ultimate impact on consumers was?

MR. HANNAH: The company that got it is going to have to charge higher prices to return that $11 million, so the consumer is not going to benefit by the most efficient company coming in on a day-to-day scenario, which maybe didn't have $11 million in their pockets.

MR. BALTO: If the $11 million was something else, if we're just talking about a discount, we're talking about a lower wholesale price, would that have made a difference to consumers?

MR. HANNAH: You're talking about up front capital versus cash flow. They're two entirely different things, and they can make or break a business. If somebody comes to a conglomerate and says, We need $11 million cash, check right now, that's fine, but if you can pay for that product over a year or two just by offering lower price, fine.

But again, okay, let me answer a question you probably have in your mind. That conglomerate does not have to charge that $11 million on that vegetable that they had in that store. They can spread it out over many divisions, many different products. A small company cannot do that.

MR. BALTO: While we go on to other speakers, why don't you figure out for us what per SKU per store that $11 million was. Pierre Tada?

MR. TADA: I think one of the points that was previously raised is, Does buyer power end up ultimately benefitting the consumer? Therefore, I have size, I can negotiate prices down, I can pass it along to the consumer, the consumer is better off.

I can say with virtual certainty in some of the commodities that I deal with that that is not the case.

I have just a recent case where prices went from -- I won't even mention the product for -- I just won't say it. Sales might go down starting tomorrow.

Anyway, the product basically went down by 75, 80 percent in the actual cost to the retailer, and the retailer did not drop the price at all. In fact, they raised the price in some cases, and in other cases it remained the same. I feel that if it was a lot more competitive at that end of the channel it would be different. You ask a retailer how do they go price their products, a lot of them focus on, What is my competitor charging?

And if the competitor isn't in existence or is not a force in that particular local marketplace, then their rationale for reducing prices is, Why should I? I have got a lower cost of product. I can increase my margins. I need to make my numbers for the quarter so I better go do that.

MR. BALTO: So, Pierre, you're saying that there are situations where the retailer gets a lower wholesale price, but you don't see it reflected in lower retail prices?

MR. TADA: Absolutely not, and you know, it's one thing to actually get a price driven down for whatever reason and have the consumer benefit. It's another thing to have the price driven down, and the consumer doesn't benefit. The supplier doesn't benefit because movement hasn't gone up because prices at the retail level have remained the same.

All it has turned into is margin for the retailer. There's no more availability. There's no price benefit for the consumer, and that's what I'm talking about as far as conduct.

MR. AVERITT: The FTC has got an active merger program that's trying to keep local metropolitan area markets competitive for supermarkets. Therefore, how can we test to see if the wholesale price reduction is or is not passed on to consumers, in some other form, in those supposedly competitive metropolitan areas?

If a supermarket is in a competitive area, might it not be forced to pass on the wholesale price reduction in the form of nicer lighting in its parking lots, for example, and how do we know whether this is true or not?

MR. BALTO: Pierre or Mark?

MR. GIDLEY: Let me address it. I'll hit both slotting and this exclusive question you posed and pass-through. First on slotting itself, there are real costs. There's both the cost on the shelf of putting the item up and the new product cost of introduction.

In terms of the merger activity, it's being driven by an SG&A gap, and I think the manufacturers need to appreciate what the supermarkets are doing today to address that gap.

Our problem as supermarket merchants are our customers are fleeing us. When a Wal-Mart Super Center opens, we lose between 50 and 25 percent of our business within a 10 mile radius. So you want to address the SG&A gap, and that SG&A gap is comprised of several differences.

One is we have unionized labor. They do not have unionized labor. We think that we get good service out of the union, and there are reasons to have unionized labor.

The second is we're carrying a lot more SKUs. We're willing to put Fred Imus up. In our core categories we don't tolerate exclusives. Let's take salad dressings because I looked at the planograms for Stop & Shop and salad dressing as a layperson, and I asked some questions. One question I asked was, Why so much space for Hellman's?

The reason is because of replenishment. Hellman's has a great brand. It flies off the shelf, so they get enormous facings. They don't pay any more for the facings, but they get enormous facing because they move the product with great velocity.

Fred Imus, he's got his brother's radio program, but he may only get one facing because that's the way the case breaks down, and it's a slow mover.

To attack the retail format that encourages 35,000 SKUs, versus a retailer format with 7,000 or 10,000, whatever Costco's got, I can tell you, I would stipulate Costco's business model is more efficient than the supermarket, but our problem is we can't lock the door on the consumer. We can't go back to Leave it to Beaver time.

We're back here in the year 2000, and customers will go to Costco once or twice a month, and they'll also go to a Wal-Mart Super Center, so part of our problem is you as manufacturers have to demonstrate what's the value.

If it's a category like corn starch or sugar, the consumer throws one in their cart, and then they'll throw it out when they move. They probably won't use the entire five pound bag where they live. On the other hand, in juices, here we are, we have a decent market share in Boston, Stop & Shop has helped introduce Nantucket Nectars, Fresh Samantha, Soby and Very Fine, and we also really took Snapple to a new level.

Snapple is carried by Costco, but they carry three SKUs. They have skimmed the three best Snappel SKUs. That's great, bully for them. People buy those case sizes at Costco, but if you want a retail format to put up ten SKUs of Snappel, you need supermarkets.

And it's an inherently less efficient model, and the manufacturers are going to have to offer real value. Slotting fees are one way of closing that SG&A gap, and people wouldn't be so passionate about it because it's real money out of your pocket, but it's also real money out of the retail format that's encouraging that SKU diversity.

MR. BALTO: Bob Houck?

MR. HOUCK: Yes. We've had a lot of talk primarily about the damage potentially or otherwise to small manufacturers of slotting allowances, but we really haven't addressed too much the damage to smaller retailers. These aren't necessarily through slotting allowances, but as Bob Reynolds said, the allowances are fungible.

In general, however, larger retailers get larger allowances and not simply proportionately larger, and there is a damage to the smaller retailer in that they cannot compete. In many cases they can't compete simply because they are not as efficient, but also they can't compete because they're not getting the same allowances. They're not getting fair pricing in effect, and there's a damage to the consumer there in terms of diminished choice.

MR. BALTO: I presume Jay Campbell will want to weigh in on this one. Jay?

MR. CAMPBELL: Frankly, the discussion that has taken place here recently is really about business dynamics. We all have to make that decision of what items we're going to carry, when we're going to carry them based on the consumer base that we have.

I have a retailer in south Louisiana that carries 75 different hot sauces. I can assure you there is nobody in their right mind that would carry 75 hot sauces including him, but he does it for image. It's a pure image ploy to show the consumer, Look how much stuff I have. It doesn't cost him that much to do it, and he's chosen to do that.

Is it a good business decision? He will have to make that decision, and if he loses money on it, that is a choice he has to make. I think we do that throughout all the categories and the products and the varieties that we carry, and many business competitors out there have chosen not to do that.

Now, I think frankly the breakdown comes between the publicly held world and the privately held world.

The publicly held world is held to a different scrutiny level because they have stockholders on the Wall Street including my 401 K, and I want you guys to make all the money in the world because my retirement plans are set.

So bully for you, make all the money that you can, and I think that's exactly what the publicly held world will do. The privately held world, which is the independent retailer, is going to do something different than that because he doesn't have to report to anyone. I think I said that yesterday. So the business dynamics are going to do that.

What concerns me, and I go back to what you just said, if those allowances, if those offerings, if those competitors got to the size they are, are striving to get to a size because there are preferences that are inequitable in the marketplace, that is where the FTC needs to involve itself.

It has a tool available to it in Robinson-Patman. It has a tool available that it can enforce without slotting guidelines, and it can go beyond slotting, into anything as it relates to products, to pricing, to packaging, to payment terms, et cetera.

So that would be the real key issue. Did a competitor get to a size in the marketplace? Are they maintaining that size through getting preferences from a manufacturer? That should be our concern through all of these discussions today, and not get caught off on the tangent of slotting alone.

MR. BALTO: Irwin Steinberg?

MR. STEINBERG: I would wholeheartedly agree with Jay. I think everybody, at least in the tortilla industry but probably the grocery industry, would say that every manufacturer should get on a shelf through innovation, through differential advantage, through pricing or service, and nobody's entitled to be there unless they can do that.

Again, from a retailer point of view, if he wants to carry one brand, no problem. That's his decision, and if he loses or wins by it, I don't see that as a problem either.

I think the FTC should focus solely on what Nick alluded to, and that is really blackmail. It is under the table payments for shelf space only, without regard to price, without regard to anything else. That is exclusionary, and clearly to me and the people I know slotting allowances paid in that respect raise prices to the consumer, because the company that's paying the allowance has to build it into their own profit margin. And at the same time hurts competition in that area.

And I think you should limit it to that.

Everything else is perfectly legitimate.

MR. BALTO: A question for Irwin and Nick Pyle: Is the problem with slotting allowances perhaps more substantial for manufacturers who can only sell their products in local markets, such as tortilla manufacturers -- that may be an incorrect fact -- or bakers? Does that sort of put you in a worse position than the national manufacturer?

MR. PYLE: Irwin and I share, our membership shares a lot of common characteristics. One of them is direct store delivery. One of them is being mostly family owned businesses.

We face unique geographic concerns because we are direct store delivery. Our bread is serviced on routes. Often when we approach a national chain or a chain in a market, our members are told, Well, you have to pay the slotting fee based on serving all our markets, you're buying that space whether you use it or not.

So where available they can expand their businesses, but often they're paying for space they're not able to use, if they're unable to negotiate a prorated amount for that.

Another area we run into, and Pamela Mills talked about this, is captive operations for baking and private label. When someone controls the private label baking for a supermarket chain, often that person then controls the rack plan or the schematic -- so who gets how much feet in the bakery aisle.

MR. BALTO: Don Sussman.

MR. SUSSMAN: Well, I just want to agree with what Jay said before about the fairness issue. I think slotting goes into all practices. To me it could be human resources. It could be costs. It could be many things that manufacturers offer retailers. Does Wal-Mart get more in certain areas than other people? It goes beyond just the grocery industry.

We're looking singling out one practice in one industry, but I think it really goes down to a total fairness issue, and ultimately I think it's the market decides, and the business model. There's different business models out there.

Costco keeps low SKUs but charges customers a fee for membership. That's their business model. Would the customers benefit if they eliminated that fee? Of course, but that's their choice to do it that way. We don't have a fee. We do have slotting allowances.

At the end of the day the customer will vote on variety, cost, efficiency. Not all retailers will make it. Not all manufacturers will make it. They never have, but ultimately I believe that the market works, and the customers will decide.

MR. BALTO: Win Weber?

MR. WEBER: Several of our clients are large manufacturers that are sitting in a closet with doors closed and lights out at the moment, but I could speak on their behalf, I believe. I think that our large as well as medium size manufacturer clients, as well as several leading edge retailer clients, all want a level playing field.

We must recognize, however, that when you're getting into the cost of doing business in terms of the efficiencies of distribution systems, Wal-Mart will be the lowest cost operator in the U.S., and everyone else is competing against that low cost. If anybody expects to be meeting Wal-Mart in terms of their efficiencies, they will not be able to do it, just because of critical mass.

Now move over to the allowance equation. I think everyone would rather work on a level playing field -- whether you call it display allowances, advertising allowances, slotting fees, however we want to serve them up. They just want to be in a fair game.

MR. BALTO: You mean from the manufacturer's perspective they want to be paying the same as every other manufacturer?

MR. WEBER: In any given category. I'm a large manufacturer, I do not want to be held hostage by one retailer and have to discriminate against another retailer, because I'm very vulnerable, particularly today when people are changing companies from company to company. If I just paid one buyer X dollars more than the guy across the street --

MR. CAMPBELL: Then you violated the law.

MR. WEBER: I've violated the law, number 1, and secondly, I have to put up with it in other ways, in retribution as he goes across the street, in terms of cost. Suppliers today would much rather have a level playing field in this whole allowance area, and the laws are already there to support that, I think as Jay has already said.

MR. BALTO: Maybe we can go back to that. I want us to spend a few moments just thinking about merger enforcement. Is the problem with slotting allowances -- and again I understand the points everyone has been making about all these other types of programs -- but is the problem with slotting allowances more significant because of the trend to mergers?

There's been a tremendous trend to mergers, something like 50 mergers that were announced just in the past year. We've brought a number of enforcement actions. The concerns over slotting allowances, are they increasing because of the current merger wave?

Jay Campbell?

MR. CAMPBELL: To answer your question directly, if a merger takes place and one of the merger parties seeks slotting allowances as a way to pay for the merger and gets preferences from manufacturers in the marketplace to the exclusion of others, they have violated the law. That should be a concern of the FTC.

If the other competitors in the marketplace are not getting the same allowance or opportunity, whether you want it as slotting or anything else, after the merger takes place, then they're paying for the merger with those bucks, pure and simple.

That's economics. It's unfair economics, but it's economics.

MR. BALTO: What's actually happening in the market? Are slotting allowances increasing because of mergers? Do people have any experience on the subject? Mark Gidley?

MR. GIDLEY: A couple of observations. The first is, and I found this very counter intuitive, I thought when one of my clients, Ahold, did these mergers, they would roll all the revenues together and just sit down and bludgeon people. That just seemed to me to be like the economic thing to do, the sporting thing to do.

That's not what they do at all, and it's taken a long time for them to beat in my thick skull that this is a local business and they have to have local buyers, so they have not centralized purchasing for 95 percent of what they put in the store. What they've centralized is really peripheral stuff. The core store offerings they keep at the same scale of the local chains that they acquire. So that's point number 1.

Now, they don't have to do business that way, but they think that they would lose a lot if they had somebody down in Atlanta making decisions on what to put up in Boston. Somebody in Atlanta would never have understood Nantucket Nectars and the fact that everybody who goes away on the Cape for three months would come back raving about these two guys selling nectar off the boat, but local buyers being in Boston could understand that phenomenon, and that's the Nantucket Nectar story, so that's one point.

The second point is that at this point in time you have zero tolerance in retail mergers. I don't know whether it's been stated or not, but as I digest your most recent activity, you're at zero delta meaning that within a geographic area very broadly defined, you cannot gain any market share, period. That's harsher than your own merger guidelines.

Now, I cannot name three manufactured good mergers that there are divestiture orders in for the last four years. I could list for the rest of the time slot all the enforcement actions in the supermarket industry.

I'm not here to say you're right or wrong. That's another debate for another day. I'm just observing that we have a lot of unnamed dominant manufacturers. They may have become dominant through their best products and superior brands. The antitrust laws say bully. If they became dominant solely as a result of merger, that might be something that the FTC would take a look at.

And I don't know that there any of those dominant manufacturers that have become so through manufacturing mergers. I just have not observed a lot of manufacturing-of-food-product merger enforcement activity. It's an observation.

MR. BALTO: Thank you. Other observations about the impact of mergers on slotting allowances? And does anybody here know whether other retailers have followed the lead of Ahold of keeping buying decentralized? Bob Reynolds?

MR. REYNOLDS: I'm not certain about this, but if you look at the Kroger mergers, the most recent of them, we're working with about four or five different store brands that they're dealing with. There are discernible different marketing programs, including, like in Arizona now, two brands in the same market with different buying responsibilities pulling out of different warehouses with different merchandising programs, with the Fred Meyer and what is it in Phoenix? Frye's.

Thanks for the help on that one. And then Ralph's in southern California, Ralph's is moving up there, Fred Meyer up in Portland all of which have different ways of running stores right now, so I think that they've adopted the decentralized program.

American Stores went to the centralized buying pre-merger. They decentralized, and now we're in an Albertson's situation with decentralized buying again. So I just don't think any particular conclusion can be drawn from that big firms mean centralized purchasing.

MR. BALTO: I don't know if anybody can answer this, but even if they don't centralize purchasing, can they still use the market clout of a bigger chain to extract higher slotting allowances post-merger?

MR. REYNOLDS: Bob Reynolds again. I think one of the main things they offer in a centralized situation is a much more powerful information base where they pull the information together in one place. They can in a sense leverage that information base both for more effective marketing towards consumers and a more effective buying back towards the vendor community as well.

MR. AVERITT: The point has been made several times that if the playing field can be kept reasonably level, it makes sense to allow businesses to pursue different strategies and consumers to make their choices about what model they want to see. That certainly has a lot to recommend it as a view when you can apply it on a national basis.

But for that approach to work it would seem like you would need a reasonable number of options in the market -- a reasonable number of suppliers, a reasonable number of retailers. The question was put by David a few minutes ago about whether that prior contingency is always true, or whether there are certain products that would trade in more local markets where retailer concentration might be higher.

Could we expand on that a bit? For example, how far are different types of produce items able to be shipped? Do you find yourself dealing with a significantly smaller number of supermarkets than the national manufacturer would? Or in the bread or tortilla businesses: Are any of you people looking at markets that are local in ways that make your business situation different?

MR. TADA: This is Pierre Tada. I think there's no doubt that the number of customers that we're selling to are shrinking, and it is shrinking because of competitive forces. I think what really goes on is competition happens on a regional basis, and pricing happens on a regional basis, and the whole competitive model is focused regionally, but the scale economies are really addressed whatever the system is, systemwide.

I think what I really am focused on is what are some of the behaviors, what are some of the competitive conducts that are going on that come with size? Is there abuse of power? Are there practices that ultimately favor certain suppliers and work to the detriment of consumers?

MR. AVERITT: What would be, for example, the four firm concentration ratio in your home region? What share of your market goes to your top four customers?

MR. TADA: Well, it depends on the region because -- and I won't mention any names, but it's really concentrated, three or four of the top retailers representing 60 percent of the market, 80 percent ranges in there, but most of the time it is on the low end of that range.

But, you know, again pricing oftentimes happens not according to the prices that they're able to extract from the supply side. It has to do with the competition in the marketplace, so they're doing store checks all the time. Okay, they're charging this, therefore I can charge that, and there's fewer competitive situations. I think it does have an impact.

But having said that, I think from the supplier side, we do have a responsibility to provide quality and service and consistency and at prices that allow the continued availability of products but are beneficial to the consumer. When it's not passed on to the consumers is where we start having an issue.

And there's a possibility that there's something in between that isn't allowing that to happen. I understand business, and it is a basket of goods. But when it starts happening more and more consistently, one begins to wonder what's actually going on, and there seems to be a fairly high correlation with increasing concentration at that level, that end of the chain, and there seems to be an increasing lack of correlation between supplier prices and what the consumer pays, and so there are things that are correlated and not correlated.

MR. BALTO: Mr. Steinberg?

MR. STEINBERG: Well, the tortilla industry is a little bit different in terms of distribution. It is largely regional, but in the west and southwest, most tortillas are distributed on a DSD basis, fresh, on the bread shelves or on end cap. If you go to the East Coast, if you go to the midwest and in the southeast, you'll find most tortillas in the dairy case refrigerated, and that's simply a measure of market size because of shelf life of a fresh tortilla.

There's not enough business in tortillas in the East Coast or in the midwest to justify DSD, although it is changing somewhat as many of you may know. It's the fastest growing bread product in the world. It's gone from $300 million to $3 billion in 1999, and that's a big jump in market size so it's becoming less of an ethnic food and more of a basic bread.

I believe Pam might notice a little bit more that the slotting allowance demands are largely in the West and Southwest where the market is very large. There are some slotting demands on the East Coast. I've heard from members who have complained about it, but it's certainly not as significant as it is in the West. I think it's related to the size of the market and the size of the market for a particular supermarket.

If you go into the barrio in Los Angeles or stores around there or in Dallas or where have you, there's much more demand for tortillas than there is in other places. And unfortunately a tortilla was viewed as a commodity up until 10, 5 years ago, so the market has just the option of saying, I'll put in the lowest price tortilla or the guy who pays me the most money.

MR. BALTO: Nick Pyle?

MR. PYLE: This is somewhat anecdotal, but I think it addresses the questions on both pay to stay and the originality. We had a baker who served out of Missouri 175 markets in the Illinois market. They were approached by this retailer after an acquisition saying that if they wanted to continue to do business they need to pony up $1,700 per store to continue to supply bread and rolls and $1,300 to continue to supply sweet goods.

MR. BALTO: Was this after a merger?

MR. PYLE: This was subsequent to a merger, and as a result it was $3,000 over 175 stores. That baker had to pony up over half a million dollars. Now, they recognized that it would take them roughly two years to make that money back, but it was cheaper for them to lose the money or take the loss, operate at the loss than to lose the volume and the economies of scale that they received from servicing that entity.

So here you have a pay to stay and you have a regional aspects of --

MR. BALTO: Was there some kind of exclusivity tied to that?

MR. PYLE: No, they were a national baker serving that account, and there were other regional bakers, but they were told that there was a baker from Ohio, and I've actually transfixed these states so it will be hard to figure this one out, but there was a baker from another state anxious to come in there that was not a regional -- very large regional baker, but not an independent baker, not one of our members, so we use this story a lot. But that's a good example.

MR. BALTO: Professor Rao?

MR. RAO: I've been listening to all this with a great deal of interest, and I notice the P word comes up a lot, power. And I've always thought that, as Mr. Weber pointed out earlier, information was a very important dimension of power, particularly in this industry. The data that I have suggests that as the retailer gets more informed relative to the manufacturer, so the asymmetry of the information between the two starts to play out, that's what has an impact on the slotting allowances.

So in terms of measurement of power, perhaps concentration indices need to be supplemented by looking at other things such as investments in information technology, access to Neilson data and the like.

The second thought that I had was that the FTC spends a lot of time worrying about whether or not prices are reducing, and I was thinking about a question that you raised earlier, David. As a consumer why should I worry if prices are dropping? One reason why I might worry is if quality drops, either commensurately or incommensurately, in fact more so, if prices drop. I'm not sure you can measure them on the same metric, but it is certainly something you want to bear in mind.

The third observation I had was the success of the new product. We're talking about slotting allowances, largely, and I'm going to defer to Greg Shaffer's distinction, that these are payments for new product launches where there is some uncertainty about demand. Nobody really knows for sure whether new product is going to work in large part because its success is contingent on the effort of the retailer, so the retailer can actually kill a very good product if something better comes along.

So to the extent that there is, and I'm going to use some jargon here, a moral hazard problem to the degree to which the retailer might put out the necessary effort, retailers would always prefer to get up front slotting fees than lower wholesale prices, because those would require them to put out an effort to make the money that they could make without having to put in the effort in the first place.

MR. BALTO: Why don't you explain what a moral hazard problem is and say a few more things about how it would fit the slotting allowance context.

MR. RAO: The unsanitized version of moral hazard is cheating. In other words, I promise to do something, it's a hidden action problem, I commit to doing something that I don't subsequently do. So the retailer commits to putting in a certain amount of effort on the part of the manufacturer's new product, and then things change. A better new product comes along, or the retailer is merged with another firm that has a different hurdle rate, and so forth. And so they do not fulfill their commitments as they had originally committed to, and as a result of which the new product fails.

To correct for all these things, you could certainly make the argument that failure fees are a potential signal, just like warranties are. They assure the retailer that if the product doesn't work, we'll pull it and we'll pay for it, but the reason they might fail is if the retailer does not put in the requisite amount of effort, and that is the basic idea behind moral hazard.

MR. BALTO: Okay, good, good. Don Sussman?

MR. SUSSMAN: Going back to the issue of supermarket mergers and buying, Ahold has a different model than many other supermarkets, but all supermarkets I think wrestle with the buying structure as you get larger and larger. Ahold has gone to market with five operating companies even though we know it's less efficient. We're duplicating buyers, we're duplicating category managers, we're duplicating overhead. We think it's the most effective way for us to sell the goods.

That might not always be true in the future, but we wrestle with the balance between being effective in terms of selling and knowing what our customers want at the local level, and being less more efficient.

Today a vendor has to call on us at five different places because we make five different buying decisions. We haven't found a better way of doing that yet. We might some day. It's always an evolution.

One thing I have found I've been doing this for about 20 years, and it's a lot easier to buy the product than sell the product. Ultimately if you don't sell the product and sell it at a profit, you're not going to get very far.

MR. BALTO: Scott Hannah?

MR. HANNAH: On the monopoly issue, again we commend the retailers here who do take on local items, but the trend is obvious. As the mergers continue, there's elimination of buying offices. There's an elimination of warehouses. In the frozen food business, some 80 percent of the products are sold through our contracted broker or sales agents.

These people have roles to try to keep up with the mergers and the buyers. The sales agents or brokers warn us severely: If we don't expand our distribution to keep up with the mergers and expansion in the supermarkets, we are dead. There's a case where mergers of supermarkets are really hurting small manufacturer.

You can't just pick and choose a market. It's impossible. And I've probably said this for about the eighth time, but the merger of the manufacturers again is detrimental with the slotting allowance to the small manufacturers. They big guys can take those slotting allowances and spread them out.

You've got 500 items in that supermarket, you can increase the price of like 10 cents an item, build a fund that will pay for a lot of slotting on some new products. You're a small manufacturer -- I've heard a lot of these bakers talk -- it is impossible to do that. You do not have the spread of a conglomerate to do that.

MR. BALTO: Let me ask the retailers. So far nobody has talked about -- nobody has suggested that buying is becoming more centralized. By the way, generally when we look at mergers, one of the efficiencies that the parties typically present to us is that they will be able to centralize buying. They'll be able to exercise more buying clout and get lower prices for consumers, and they do suggest that buying will be centralized, but let's assume that hasn't happened so far.

But if it does happen, what's the potentials? Let me just ask. Maybe you could clarify for us a little more. Why isn't it happening, and is it likely to happen more in the future? Either Don or Mark?

MR. SUSSMAN: First, I think it has happened. Really it's a business-by-business situation. What I was giving was the Ahold experience to this point. That's not necessarily the industry experience.

MR. WEBER: I think we've had significant centralization of buying, from a standpoint that prior to category management, that we'll get into later, each store made its own decisions some years back. We've moved from each store making a decision to, in some instances, regions of chains making the decisions for the stores. In other instances, it is no longer the store but a centralized buying decision at the corporate head office.

So I think that if we look at centralization, we have to start with the store, and not where we are today and look at it just through mergers. There's been considerable centralization of decisionmaking in this industry.

MR. BALTO: Anybody can answer this, maybe Peter De La Cruz or any of the manufacturers. To the extent that buying is becoming more centralized, what are the implications of that for product diversity and consumer choice? Pierre?

MR. TADA: First I wanted to touch on central buying and consolidation. I think with the advent of mergers, one of the key rationales put forth is that, yes, we can reduce our cost, centralize our buying, reduce overlapping administrative costs and so forth.

And the state of purpose of the buying office is, We're going to have to justify this merger, so we'll have to drive down the price of the products that we're handling, and we have to pay for the merger so we need to keep our margins intact or rising.

So there are some costs to the merger, and they're really facing the capital markets and the promises. I think we all understand that. And I think there is an impact especially to the smaller guys, and even to the larger folks, that that's actually going on.

I'll put forth the comment that what we're really dealing with is some radical changes in business models, not only at the retailing level but at the supplier level and globally. There are different competitive responses that happen related to these competitive forces. We talked about Wal-Mart and Costco, very different models in different ways, that have driven cost out of this system and efficiently handled products, and it's a new model, and then there's the rest of the industry that's trying to respond in different ways.

I would put forth that responding to that competitive force to the detriment of small suppliers, medium sized suppliers, is really not what was intended, I don't think. I think it's coming back to what I mentioned earlier, about behaviors and what's going on in the marketplace.

And I think ultimately some of the activity really does have a negative impact on consumers, and, frankly, a negative impact on consumers is a negative impact all the way through the system, including suppliers like myself.

MR. BALTO: Mark?

MR. GIDLEY: Very quickly. I think what's good about this dialogue, and I appreciate the FTC for creating this forum, is life is hell for the small and medium sized manufacturers. If we did have one of the unnamed dominant manufacturers here, they would tell you life is hell for them too. They would talk about what they've had to do, what cartwheels they've done for Wal-Mart and what kind of product support and cost Wal-Mart has imposed on them.

That's not necessarily bad for the consumer. I look at Wal-Mart or Costco and I marvel at what the consumer gets today. The consumer gets today unbelievable variety from the supermarket, extremely strong variety from Wal-Mart and a very low pricing from Costco so the consumer, I know, is winning.

I think everyone here, at least from the supermarket retailer side, we're losing. Our problem is our model goes back 50 years, and our current Super

Center model goes back 20 years. Is the sun setting on that model?

We can bring in some small slow movers, but we can't have a store of slow movers. Our stores are full. Our planograms are full. We're at 1 percent margin, so we're happy to bring in your extra SKU, but there is a cost to that extra SKU. We're bumping something that's a known.

So the business problem remains for the supermarket industry. We are high variety, high service, often unionized, 1 to 2 percent net margin, and our store is full. You have new products. If I understood the speakers yesterday, the number of new products has doubled. Again the consumer is not hammered. The consumer is benefitting from this explosion in ideas, and I heard earlier that there were these great products that didn't come to market.

I'm sure every company has got great products that didn't come to market. I'm sure somebody out there wants to sell blueberry corn flakes and then strawberry corn flakes and every infinite permutation of a type of cereal.

We have limited space. We made this enormous investment in the store. We're on the hook for a 30 year lease that cost us 10 to 20 million bucks per store, and we don't have that kind of Leave it to Beaver situation where that store has a guaranteed stream of income so our problem is extremely real.

And I think the manufacturers have really got to look in their souls and say, How do we add value to these guys that are getting sizzled badly.

MR. BALTO: Mark, that was a good articulation of the point of view, especially on new products, but I gather you would never advise a client to charge pay to stay fees. What argument you would make to justify pay to stay fees?

MR. GIDLEY: The easy answer as an antitrust lawyer is that I need facts. I can defend the known. I'm good but I'm not that good, so I can't defend the unknown. My client hasn't brought me a pay to stay contract. If they did, there might well be a defense, and I would want to know more about the circumstances, what the choice was being made versus staying. There could be an opportunity cost of that SKU staying.

That's not what my client does. My client, 99 percent of the time we're offering slotting fees only for a new product. Once you're in, you're in. So you need facts.

MR. BALTO: It's okay, Mark, you have until three o'clock, and then I get another bite out of you.

MR. GIDLEY: Sounds good.

MR. BALTO: Bob Reynolds.

MR. REYNOLDS: I have no instance of this actually happening, but let's say that a competing supplier came in, in a narrow product line, and we were offered an amount to make the switch, offered a big slotting fee. So the retailer sits there and says, Well, I'd just as soon keep my Kingsford corn starch on the line but I can't afford to do it unless I'm asking it to pony up some money to stay on the shelf.

Now, Kingsford then has the option of either paying that or seeing their brand going out of the store.

MR. BALTO: Okay.

MR. REYNOLDS: It's a business decision at that point.

MR. BALTO: I wanted to turn to Rick Warren-Boulton. Rick's actually given a good deal of thought on the monopsony side and mergers. Unfortunately he hasn't been successful recently in arguing those points with the antitrust division of the Justice Department, but I thought Rick could illuminate for us the kinds of circumstances where antitrust enforcers should be concerned about monopsony issues and merger policy.

MR. WARREN-BOULTON: I resent that. First of all, I should point out that we're doing very well in Microsoft, and secondly --

MR. BALTO: I don't think it's a monopsony claim.

MR. WARREN-BOULTON: Secondly is that we did do your office superstore merger in one. This is biting the hand that feeds you.

The question that you started off with was, What's the nexus or what's the relationship between supermarket mergers and these fees? There are three kinds of concerns that the FTC could legitimately have with respect to supermarket mergers.

The first is simple monopoly power. It's a perfectly legitimate concern, but it's very hard to see what slotting fees have to do with that.

The second is what you would call classic monopsony power, and that's the situation in which the supermarket is facing a seller who's very regional, has local transportation costs, and actually the supermarket looks at them and says, Gee, if I reduce the price that I'm willing to pay, this guy will in fact reduce the price, but he'll supply less, okay? That's our classic monopsony situation.

Now, I don't know how frequent that is. My impression is that classic monopsony power by supermarkets is a pretty rare event, and what's more, since the purpose of this discussion is not whether or not mergers create monopsony power, but what the relationship of slotting fees is, an economist would probably argue if a merger between supermarkets did create monopsony power, that a slotting fee is probably a less efficient way for that to be exercised than through simply driving the price. For the economist in the group, it's clumsy. It's first degree price discriminating monopsony.

What does that leave with you as a real concern with mergers? I think that the answer as I've been sort of plugging here, is that if your real concern with slotting fees is a narrow, limited set of situations in which a dominant manufacturer is basically bribing a supermarket to impose costs on rivals or to reduce the amount it's willing to pay, where the purpose is that the manufacturer is trying to preserve monopoly power, and Microsoft is a good example of that, perhaps in an extreme, what's the relevance of supermarket mergers?

And the only relevance I can see offhand is it does in principle make such a deal easier. If what you're trying to do is tie up 80 percent of the market under exclusives so as to drive out a rival that has economies of scale, it's probably easier if that 70 percent of the market is in the hands of ten supermarkets than 500 supermarkets.

That being said, though, we're talking simply about reducing what economists would call the transactions costs, that slotting fees will reduce the transaction costs of exclusion.

Secondly, if indeed the fact of the matter is that after a merger decentralized buying is maintained, it's hard to see how the merger is going to in fact reduce the transactions cost to a dominant supplier of putting together that critical mass.

So it's there in principle and perhaps it should be looked at. I would say that the first obvious thing to look at if one is concerned about this sort of thing is empirically to ask this question: If you look at the supermarket mergers that have gone through, is it a fact that after those mergers there was a significant increase in the slotting fees paid for established products?

I would look at it both as a time series before and after the merger and also as a cross-section comparing large supermarket chains to small chains. That's an empirical fact. If you do not find that to be true. . . that's a necessary but not sufficient condition for concern here, so before beating ourselves over the head it probably might be nice to sort of check out what is the critical necessary condition for an anti-competitive hypothesis.

MR. BALTO: Yes. Irwin?

MR. STEINBERG: Just a short story. There was a recent acquisition by a major supermarket chain based in San Francisco of a major supermarket chain based in Dallas, Texas, where I happen to shop and buy tortillas occasionally. I noticed prior to the acquisition there were probably four brands of tortillas in a given store -- one or two stores that I go to -- and now there are only two.

And those two brands in the stores in Dallas are two companies who are more or less national and who pay large slotting allowances to the San Francisco based company for their California activities. I don't know if it's a coincidence or not.

MR. BALTO: I wanted to end things with a simple and uncontroversial question that I don't think anybody would be interested in answering. What would happen if slotting allowances were banned? How would that affect retailers, manufacturers and especially consumers? Bob Reynolds?

MR. REYNOLDS: Virtually nothing would happen.

There would be a shift, and if you were able sufficiently to find and prohibit slotting allowances, there would be a shift in the way that monies were spent to different kinds of deals and allowances with the same result in terms of transfer of funds from the manufacturer sector to the retailer sector.

MR. BALTO: But would some of those be more efficient? In other words, if slotting allowances went into couponing or just a discounting off of list pricing, wouldn't consumers be better off?

MR. REYNOLDS: That's a matter of opinion and how the individual firms happen to account for the revenues. I know of some major chains who plow them all against cost of goods and some who don't, so you have to come up with that distinction before you can make that conclusion.

MR. BALTO: Peter De La Cruz?

MR. DE LA CRUZ: I would say just on couponing, that at least from the manufacturer's perspective, the coupon would be directly related to their product sale. And slotting allowances -- there's no necessary correlation between product promotion and the slotting fee you pay.

I just want to back up. I think one aspect of the merger analysis needs to be the impact on the supplier or manufacturer sector. I think Irwin's story sort of is a predicate for my remarks in that regard, in that generally I think the history of branded goods starting in 1890s has been an attempt by manufacturers to reach consumers directly. As stated earlier in the panel, because of the multiplicity or diminution of network advertising, and I guess the different kind of communications environment we live in today, that shelf facing or shelf space is a critical way for communicating with the consumer.

You can see a situation where you would have less competition at what I'll call a branded or primary goods level and actually weaken competition there, so you would have one or two dominant manufacturers with some private label folks, and typically the private label folks are cheaper because they don't invest in R&D, that sort of thing.

So I think one of the implications is not only health for the consumer directly in prices, but health long-term in the manufacturing and supplier side.

MR. BALTO: Nick Pyle?

MR. PYLE: Briefly I think that the entry fee would morph into some other thing like a computer charge or a computer set-up fee or something like that, or a warehouse fee or a stocking fee. Interesting, our bakers are often change charged a warehouse fee when we do direct store delivery.

If it comes back, we send it back and say we don't use their warehouse, it will come back as a computer charge or an SKU fee. It's interesting.

But you have to draw a very fine line for when you're paying a fee that's a lump sum that's not tied to volume or price. If you're doing something different, a facing fee to bring your product up to eye level or street money to put you in the middle of the aisle, that's different. That's value added, and you have to draw a line.

So I think the no-value entry fee lump sum is going to morph into something else.

MR. BALTO: Let's see. Pierre Tada I want to do the manufacturers first, and then the retailers and then the consultants.

MR. TADA: I think if the slotting fees were to disappear all of a sudden, and assuming it wasn't the water bed effect where you push it down over here and it comes up over there, that there would be more focus on the product and more sensitivity to the movement of the product and consumer prices, and I think it could actually bring consumer prices down.

I think it would encourage some innovation in competition, and I think the skew towards bigger will be a little bit more balanced to big and small.

MR. BALTO: Let's turn to the retailers. John Eagan, did you want to contribute?

MR. EAGAN: Yes. If they were banned, it would come away, it would come back as a different form. There's no way it's going to go away. They're not going to leave it with the manufacturers. They become dependent. The retailers become dependent upon it in my opinion. The best way to address it probably would be to give some guidelines, give the manufacturers and retailers some guidelines, and let us play on a level playing field, and investigate where there seems to be things that are going awry.

MR. BALTO: How many other business people here at the table think that guidelines would be a good idea? About four or five hands. Jay Campbell?

MR. CAMPBELL: The question would be what would happen to those funds and how would they end up back into the marketplace. If it stayed at the manufacturer level and went on their bottom line, fine, then your 401 K goes up and you're real happy. But if we believe it's going to go into the lower price of the product, I think we're being very naive.

I think the reality is if it goes to the power buyer disproportionately than the other competitors. Then you have a discriminatory impact, and I think that will be the real concern, and that should be the concern of slotting today. Is it disproportionately being distributed in the marketplace?

MR. BALTO: Don Sussman.

MR. SUSSMAN: I think there's a number of different scenarios. One is that supermarkets will make less money. In that case I would hope you would have room for me over at the FTC, David, because I don't know where I would be. So let's reject that one out of hand.

MR. BALTO: Absolutely, Don. You noted what the salary scale here was.

MR. SUSSMAN: So I think really what would happen is, first, some of that money would come back to the retailer from the manufacturer in other ways. Some of that money would be put into the manufacturer's pocket. Some of it would be spent on the customer, marketing to the customer. Some prices would rise.

If all that money doesn't come back to the retailer to protect our bottom line, there would be upward pressure on retail prices. It depends on the marketplace -- if we could get it or not -- but the bottom line is it's got to come from somewhere.

I also think there's going to be less items on the shelves. Today we take in thousands of items. There is real cost of putting those items through the system. There is really risk associated with discontinuing items. If new items come along without fees associated with them, there would be less reason to take items, take on the risk and take on the expenses, so I would see us taking on less items. There would be less reason to take on items.

MR. BALTO: Would your answer change if only pay to stay fees were banned?

MR. SUSSMAN: I guess as somebody who doesn't use those as a business model, and doesn't see the value in those, I have less problem with that. I guess I don't like the idea of being constrained in the way we do business. I like to choose. I would like to put that aside as a bad business practice that we wouldn't use because it's a bad business practice, but I don't like the government getting involved in how we run our businesses to the same extent as you probably would like to.

In terms of guidelines, I would have problems with guidelines because a store is not a store. There's a difference between a convenience store, a ma and pa store, a warehouse store, a Stop & Shop that is 70,000 square feet and has 30,000 customers going through it every week and does over a million dollars of volume.

So the idea of a guideline sounds reasonable in the broadest sense, but when it comes down to specifics, I would not want to operate within guidelines, and I would rather the market functions and let the customer decide whether we have an efficient and a good business model.

MR. BALTO: Mark, you get to weigh in on this question on the last panel. Why don't we turn to Bob Houck.

MR. HOUCK: There seems to be a general agreement that it would have to be made up in some way or another. I was just doing some quick math, and I think that the total grocery market is something in the vicinity of like $350 billion or something like that. The number has been adverted to here that slotting allowances are around 9 billion, which means that they are around 2 and a half percent of the total volume in the market, which I think is probably pretty much equivalent to the profit margin of the grocery business.

So the economists have told us that up front lump sum payments generally are not passed on to the consumer, that they tend to go to the profit. Well, that would mean that the slotting allowance is pretty much equivalent to the profit. If we took the slotting allowance away, it would have to be replaced with something equivalent and would have to be replaced with something equivalent that does not go to the bottom line or is not performance based.

MR. BALTO: Win Weber.

MR. WEBER: I believe that if we took the slotting allowance away, it would just be served up in another form, and the retailer will still manage their buckets of money however they financially account for their business. Some are true net cost operators who drop everything right down into net costs. Others put their monies in their various pockets.

I agree with Bob, to try to eliminate the slotting allowances will not change one iota the financial structure between the manufacturer and the retailer, other than the fact that the monies will be served up differently.

There is a perspective, though, in terms of pricing. I think we should keep in mind that Wal-Mart is spending slightly under $1 billion on technology this year. As a percent of $165 billion in sales, actually it's a relatively low percent versus what other supermarket operators have to spend.

That technology investment that Wal-Mart is applying is going directly back to the consumer almost by the dollar, either in service and price. The market right now almost has a retail price ceiling out there wherever there's a Wal-Mart Super Center, and in that context I think the issue of are consumers being served today, I think the market today is more competitive and serves the consumer better than it has in years.

And I think slotting allowances are such a small percentage of that total and so insignificant relative to the magnitude of what's going on out there today that I don't even see this as an industry issue.

MR. BALTO: Scott Hannah?

MR. HANNAH: Elimination of slotting allowances again would level the playing field. Slotting allowances right now are the primary reason I think that small, medium sized manufacturers are being driven out of business, vis-a-vis the tortilla industry down there.

If a retailer came to me as a small manufacturer and said, Well, we're going to have to make up the money in other ways like trade allowances, I would say great. You want to put up more displays in my product, more ads in your store, more coupons, that's excellent. I'm trying to reach the consumer, so the consumer wins. The consumer knows about a product.

Off-invoice allowances are very, very common. There would be more off-invoices allowances, deeper, which the retailers pass on so they would get a price advantage. That's a win/win situation.

MR. BALTO: I know we've gone over this, but this is an important point. I want somebody to respond to Scott's point, because a lot of other people have said, Oh, it doesn't make any difference ultimately to consumers where this money goes, and Scott describes the scenario where it really does make a difference if the money goes into slotting allowances or something else.

So what's the answer to Scott's comment?

MR. SUSSMAN: Well, there's a difference between spending the money on the customer and putting money in the retailer's bottom line. Running more volume can help put more money in the bottom line but not necessarily so. If you give me a thousand dollars and I put it in the bank, or you spend a thousand dollars on my customers, that's not the same to me in an economic sense. There is value to spending a thousand dollars on my customers but not necessarily dollar for dollar.

MR. BALTO: Thank you very much, the panel. This has been very informative. We get back together in an hour and five minutes. The closest place for lunch is The Top of the Trade, which as you will recall has fried chicken with homemade potato salad on the 7th floor. We'll start promptly at 1:30 on category management.

(Whereupon, at 12:10 p.m., a lunch recess was taken.)

AFTERNOON SESSION

(1:30 p.m.)

PANEL 4: CATEGORY MANAGEMENT AND CATEGORY CAPTAINS

PANEL 4 MODERATORS

MIKE ANTALICS, FTC
CHRIS GARMON, FTC

PANEL 4 GUESTS

JEFF SCHMIDT (Attorney)
CHRIS MACAVOY (Attorney)
BOB REYNOLDS (Consultant)
SCOTT HANNAH (Pacific Valley Foods)
BOB STEINER (Consultant)
GREG GUNDLACH (Professor, Notre Dame)
BART WEITZ (Professor, Florida)
DON SUSSMAN (Ahold)
IRV SCHER (Attorney)
WINSTON WEBER (Consultant)
KEVIN HADE (Ukrop's)

MR. GARMON: This is panel 4, the category management and category captains panel. The way we're going to work this panel, what we thought we would do first, after we have everybody introduce themselves as before, and hope that all the chairs and tables stay together --

MR. SUSSMAN: I didn't do it.

MR. GARMON: What I thought we would do is we'll go around and first try to define what category management is, what category captains are, and then we have a short video to show you, and then after the video, we'll talk about some of the potential antitrust implications of category management.

So starting with my right let's go around, and everybody say your name and your affiliation and what you do just briefly.

MR. ANTALICS: I'm Mike Antalics. I'm deputy director in the Commission's Bureau of Competition here.

MR. REYNOLDS: I'm Bob Reynolds, Reynolds Associates from California, and I work on marketing issues associated with the grocery business.

MR. MACAVOY: I'm Chris MacAvoy from the Howry, Simon, Arnold and White law firm. Our firm represents a lot of different interests, retailers, manufacturers. I personally represent a lot of retailers and have done work over the years for the Food Marketing Institute, which is a trade association of grocery retailers and wholesalers.

MR. BALTO: I'm David Balto, and I used to be employed as a moderator for the FTC.

MR. GUNDLACH: I'm Greg Gundlach, professor of marketing at the Mendoza College of Business at the University of Notre Dame.

MR. HADE: Kevin Hade. I'm vice president for category management for Ukrop Supermarkets in Richmond, Virginia.

MR. HANNAH: Scott Hannah, CEO, Pacific Valley Foods, Bellevue, Washington.

MR. SUSSMAN: Don Sussman, executive vice president of purchasing and supply chain for Ahold U.S.A.

MS. MILLS: Pamela Mills with the Tortilla Industry Association and also a tortilla manufacturer.

MR. STEINER: I'm Bob Steiner, for 30 years a consumer goods manufacturer in Cincinnati in a number of different industries, then a professor at the University of Cincinnati, and then came to the FTC and the Bureau of Economics, and now am just doing some writing and a little bit of consulting.

MR. WEITZ: I'm Bart Weitz; I'm a marketing professor from the University of Florida.

MR. SCHMIDT: I'm Jeff Schmidt with Pillsbury, Madison and Sutro, and I represent the Grocery Manufacturers of America.

MR. WEBER: I'm Win Weber, president of Winston Weber & Associates. We consult with both retailers and suppliers and are known as one of the three leading firms in the world in the design of category management.

MR. GARMON: And again, I'm Chris Garmon, an economist here at the Federal Trade Commission.

I thought we would start out today with a question to Don and Kevin. What is category management? How do you use it? Why do you use it? How does it benefit you?

MR. HADE: I'll go first. Again Kevin Hade with Ukrop Supermarkets. I guess I get that question a lot from consumers when I call them and ask them about a product. Vice president of category management means nothing to consumers. It's an industry word, and then I explain what I do, so I'll tell you what I tell consumers.

Primarily my responsibility with Ukrop's and our group is to manage the product assortment and merchandising strategy of our company. I think the word category management, how we interpret it and apply it to our business speaks to leveraging and the use of technology to manage product, price, promotion, et cetera.

I think this whole thing has really come about as the technology wave and information age has taken a foothold in our business over the last 10 or 15 years.

MR. SUSSMAN: Not much different, other than we would look at category management as a way of taking our large business, like our grocery business, and breaking it down to smaller business and having ownership of that business by a person or a team. That group then takes responsibility for understanding the customer better -- pricing, promotion, all the things that we do with that category -- but giving ownership to that business.

So we take a large business which is huge, which is 30,000 SKUs, and break it down into manageable chunks, adding people to it, adding information to it so they can make better business decisions. We think at the end of the day, we'll do a better job satisfying our customers' needs and running a business.

MR. GARMON: How does that differ from what happened before category management came around?

MR. SUSSMAN: Well, for us what you had was a lot of specialists. You had one group of people that just did replenishment, another group of people that just worried about shelf allocations, other people who just did negotiated deals and other people who planned promotions, and what we've done is we try to shrink it down and give kind of a cross-functional view to a smaller group of people.

So the same person making the planogram decision makes the assortment decision, makes some of the pricing decisions, and certainly makes the promotional decisions. The same business was being done, but rather than having specialists do it, we've given ownership to a smaller group of people to make more of the decisions for the category.

MR. GARMON: So would it be fair to say that responsibilities are now delineated by category and before they were delineated by task?

MR. SUSSMAN: Absolutely. For us that's true.

MR. GARMON: My next question I would like to direct towards Bart Weitz. How is category management used in other retail trades, to the extent that it is?

MR. WEITZ: Well, let me give an anecdote. My coauthor and I wrote a retail textbook that's used in a lot of universities, and my coauthor is more familiar with the apparel industry and department stores, but he wrote the chapter in which you would include category management under merchandise management.

He was totally unaware of what category management was, because in a department store everything is managed by category management, where in the Gap you will always see category management, and it's really very unique that this has come late to supermarkets.

I think that in addition to this cross-functional integration, category management really means sort of. We're going to manage, let's say, the detergent category as a collection of products and sort of try to find a global optimum rather than making deals with each brand on a brand-by-brand basis. And as I said, in department stores and in apparel stores, that was always done that way.

The other thing that's a little bit different is that in a department store, you would never sort of say, Well, Liz Claiborne, I want you to come in and organize the women's category for me. I mean, the buyer or the people in merchandising for Women's would do it, and it's fairly unique to the supermarket industry that you would have such things as category captains.

MR. GARMON: Before we get into category captains, specifically how does category management benefit you as a retailer? Does it increase the revenues of a particular category, and if so, is it mainly in terms of movement, or is it in terms of the prices that you can charge? Maybe, Kevin, you can start.

MR. HADE: Great, I will. Thank you, Chris. Kevin Hade again with Ukrop's.

First I just want to tack on to a comment earlier as well, How does product category management differ today versus maybe 10 or 15 years ago? I didn't have the privilege of being around 10 or 15 years ago at our company in this capacity, but one of the things I think has changed a lot was, if you look at our industry as a whole, it was a very instinct-based business for many years, where people made decisions by the gut, grew up in the business and knew what to do, et cetera.

And I think today it's just become so much more sophisticated you can no longer do that, and I think there's a big flow in that direction.

To tack on to your current question, I think we're looking at how to maximize profitability. I don't think it's about how to charge more for products or do that type of thing. We look at a plethora of data in making decisions, marketing data, scan data, data provided by the vendors in the area, as well as we have a loyalty card so we understand what individual households are purchasing.

We mesh all those factors together to try to maximize consumer satisfaction as well as profitability so we can compete against larger companies. I think that's what we're doing today, and that's probably the difference in our business.

MR. SUSSMAN: I just want to add, there's a long-term planning aspect of category management that didn't exist before. Their planning was usually ten week cycle for most supermarkets. Every week you do the next week ten weeks out, and it was almost a week by week struggle.

Category management really steps back and looks at a category over a period of time. You do much more planning, long-term thinking about the category so that's something that's helped our business.

In terms of what the benefits are for the retailers, we look at it as sales, customer satisfaction and then profits leading from that, and they come from all different ways. There is a cost element that could be there, but the bigger piece is the selling element in terms of having the right products on the shelf, the right price and right assortment, so we look at customer satisfaction and sales.

MR. GARMON: Maybe to make things more concrete, since category management seems to be a very theoretical topic, let's take two categories. I've been in the grocery store recently. Cereals I often see are arranged by brand, Kellogg's, General Mills and Post. In one store recently I saw that salad dressings were arranged by types, French all together and Thousand Island and so forth.

In making a decision like that, just in terms of product placement, how would you use category management to decide whether to place things by brand or by flavor? Either Kevin or Don?

MR. HADE: I'll try to take a stab at that. I think as I mentioned before, category management is not about -- I think I'll use my analogy again. I think 15 years ago some guy would have come in and said, Hey, I think I would like to try it this way and see what happens.

I think today's business is much more sophisticated. I think you have the ability to try things and measure the results. Sometimes you can -- you have the data. Maybe it's been tested somewhere else, and a vendor is coming to you and saying, Listen, on a national level we're recommending you shift to this type of merchandising segment and we can show you the data to support. We think we can increase your movement, profitability, by a certain percentage.

At that point in time, if we were swayed by that argument, we would probably make a decision to test it in our environment and see if we achieve some of the results. Again within the category management system today, we have the ability to look at different specific goals we were looking for as a result of the change.

Maybe it's not all just about driving profitability. We may want increased penetration of a certain type of cereal within our top two or three deciles of consumers. I mean, we can select the criteria we're looking for to measure the success of that change, implement that change, and then come back and post-measure that.

If we haven't achieved that, we keep working at it. I think as Don alluded to earlier, this isn't about a one-time fixed category management. We are constantly evaluating strategically the short-term and the long-term. And the environment is constantly changing, but within each one of these subcategories you have to constantly be thinking about how the environment is changing in your area.

MR. SUSSMAN: In terms of how we set an aisle up, one of the bases of category management would be the consumer decision tree. That's trying to understand how consumers in a category think about the category, how they shop it, how they're segmented in terms of their needs, and how the products themselves are segmented.

The consumer tree can be based on interviews, an understanding of the customer through market research. It can be based on empirical evidence in terms of how people purchase. Often we turn to our vendor partners if we're using vendor partners, or at least vendor input, for their view of how they see the customer.

And in the case of Stop & Shop we use multiple vendors -- and I'm sure we'll get into that issue -- to understand the views. This is how the customer wants to shop it, how should we organize ourself to fill their need?

Now, sometimes we try things that fail. Sometimes things seem intellectually obvious but the customer rejects them. One of our competitors set their soda aisle by flavor and said, Okay, all the orange sodas will be in one section. It makes sense if you want an orange soda. Very confusing for the customer. Six months later they reset it.

It made sense intellectually, and certainly people think about it differently. They don't know always know that Coca Cola has an orange soda, so the answer to your question is the consumer's decision tree, multiple inputs to that, and then once we decide how the customer wants to shop, then we try to figure out how to satisfy their needs.

MR. GARMON: Bob, you had a --

MR. REYNOLDS: I was going to use that very same example of the difference between Stop & Shop and Shaw's soda set, which I saw four or five years ago when the Shaw's set was all by flavor.

MR. SUSSMAN: I was holding back.

MR. REYNOLDS: But it was interesting, I'd never seen it that way, but you also have to understand that Shaw's is heavily dependent on their private label program, and this was a way to demonstrate the difference between price of national brands versus private label in the soda sector.

So the point is that if Shaw's and Stop & Shop were both using a high-power category management program, and they both were at the time, it doesn't guarantee the sets are going to look the same because there's differing philosophies in the process as well.

MR. GARMON: Now, we have heard a few comments about supplier inputs, and I wanted to talk about category captains. If either Bart or Don or Kevin could tell me what is a category captain and why are they used? Maybe we can start with Kevin.

MR. HADE: Sure. Primarily, as we alluded to earlier, category management is a segmentation of segments of the business, so to speak. Within say the grocery category, we may break that down into maybe 100, 120 sub-segments or sub-categories.

The use of the category captain usually entails looking within the vendor community and selecting either the primary vendor or secondary vendor and assigning them the status of captain of the category.

Let's use the example you brought up, Chris, earlier about cereal. In that case you're going either to the vendor or the broker who represents that particular segment, whether it's Kellogg's or Post or General Mills. In fact that person theoretically is the main conduit between the vendor community and the retailer. That doesn't mean that we don't meet individually with each of the vendors.

What it does mean is when we make a decision to potentially rework a set in a particular area, in this case again cereal, taking the internal structure of Ukrop's, we would communicate to the captain that, Here are some things we would like to see done within the set. We would like to add the following products, we think we would like to take the following products out. Can you work out with the other vendors in this set a way to do that and bring that recommendation back to the team?

And they would work collectively with people, with our staff, et cetera, so maybe it's an added service that the vendor community is providing the retailer. They are very focused and knowledgeable about cereal, much more than we could be.

We can't afford to have a category manager for 140 categories in a grocery chain our size. Certainly I don't know where that breaks out. I mean, we have one category manager for our grocery business who has to manage all those subcategories.

We're very dependent on that information, and I think it helps build our relations with our vendors.

MR. GARMON: Are category captains needed for category management? I would like Don to --

MR. SUSSMAN: At Stop & Shop we don't have category captains or partners or any lead manufacturers. When we started the process a couple years ago, we did rely on, if you will, a partner in each category, and that was both for information flows, which they have available to them, at least they had available to them that we did not have, as well as expertise that they would bring to the party.

Today in Stop & Shop we have our own information sources. We still are relying on the vendor for market research and customer issues, but we don't rely on any one. We look to validate it and take input from all our vendors in a category, or at least many of the vendors in a category, so we don't think we need it.

We don't think it's good for our business at Stop & Shop. We still have -- some of the Ahold companies are still more relying on vendors. Our goal is to get everybody off of reliance on vendors and just using multiple vendors for the customer input.

MR. GARMON: On that topic, I can send the question to either Bob or Winston or Bart, do you think the use of category captains is sort of a transitional device in category management? Do those companies, whether in other retail trades or in grocery stores, to get started using category management would need a category captain, but then eventually would not? Yes?

MR. WEBER: I think first of all we, even though we're involved with retailers and suppliers we don't agree with the word "category captain" to start with. I think it has some implications that an individual or a company actually has control of a category, and in any progressive, successful retailer today, the category managers are taught to listen to all suppliers because that's how they make the best business decision.

A lead supplier let's say, which you were referring to, Don, a lead supplier is used or possibly identified for many reasons -- their available resources, their position in the category in terms of their knowledge of the consumer, and et cetera and et cetera, et cetera. They can be an important resource to that category manager to help the category manager make good business decisions.

The retailer has certain information that the supplier does not have, which is basically POS data, internal research. The supplier has certain information that the retailer doesn't have -- new product introduction plans, advertising plans, is advertising going to increase this year or decrease this next year.

By aligning this information, both parties are better able to align their strategies, their tactics, and, if they can do that, the consumer is ultimately going to benefit from better business decisions. So I do not look at the captain as a transition person at all, or a lead supplier as transitionary.

Worldwide we have yet to find one supplier, or one retailer rather, who could support category management the way it's written in the textbook. This is not saying the textbook is right, because the textbook records a highly complex process with many templates and so forth, but if we were to follow the textbook of category management, there's not a retailer in the world including Wal-Mart that could truly marshal the resources themselves without some type of support from a supplier.

However, recognizing that over 90 percent of all retailers say they're following the textbook, but practically speaking only 10 percent are close to following the textbook, I think we do best to look at this as category level planning. Taking the word "category management" out of it for a second, we recognize that we have a broad range of applications to a basic business planning process called category-level planning that we're allowed to do today because we have the technology available to give us information down to the category level, SKU level.

Ten years ago we never had that information any lower than the department level, and so it's a matter now of taking the technology and information we have available and applying that to help us make hopefully better business decisions, and the point you were making at Ukrop's, moving from that gut-feel, relationship-selling environment to where we've moved much more toward a fact-based decision making environment today.

MR. GARMON: Yes?

MR. WEITZ: I think there's actually no issue that sort of managing at a category level is better than managing at a brand level, and having cross-functional integration is better than not having that integration in terms of an efficiency argument.

I guess the issue is whether you want to reject the word "category captain" or not. It's a broad spectrum of the influence that one manufacturer might have in terms of influencing how that category is managed for a retailer. So you see actually in the Ahold case that they move from starting out with having the manufacturer have a lot of influence, to moving to a place where the manufacturer -- the key manufacturer or the dominant manufacturer -- doesn't have that much influence. All the players in the category have an influence in the decision, but the decision is made by the retailer more than the category captain.

And if you look at it from that perspective, I think that dominant manufacturers want to have their products sold more than their competitor's products sold. Now, of course, if they abuse that they'll be thrown out as being category captain, but ultimately it would seem to me that the retailer has to take more and more of that responsibility.

So I would contend that this idea of having the dominant manufacturer have a lot of influence over what items and what promotions are made in the category is actually decreasing over time.

MR. GARMON: Let me go to Kevin for just one question on that. How do you choose your category captains? Since you mentioned before that you really can't follow the Ahold model here, you're too small to do that, how do you choose your category captains and how do you determine whether they're giving you advice that's not biased?

MR. HADE: First let me speak to another question. In looking at this in a cyclical standpoint, I believe that potentially this type or way of doing this is maybe a step in the process. We are an organization that's relatively new to this type of thinking. This type of thought I think has been embedded at the vendor level for many years, and this is almost like a transfer of information of how we think and how we analyze categories, et cetera.

And I think early on in your life cycle of this process you probably are more dependent upon the sophistication of thinking from the vendor community. So if we come back here five years from now, and I hope we don't have to, then we might have a different answer, maybe closer to what Ahold did today within that thinking.

Getting back to your most current question, it's not a one size fits all by category criteria, and it's not that biggest guy always gets it, et cetera. I think just as important is that factor of trust. How well do we know this particular vendor? What has been their performance for us in the past?

As we've testified in a couple of the other sessions today, I think relationships are very important to our company. We're not just about the short-term, and I think we're fortunate to have a number of people that we've worked with for many years, we have a lot of trust with, and they don't abuse that.

I think there are checks and balances within the system that, should they attempt to abuse their empowerment in this particular case, they're going to find themselves on the outside looking in. Again we have checks and balances in the system where we can make that work.

But I think it's a mixture of having a certain amount of knowledge and business volume within the category, but probably more importantly how good do we feel about how well this person really understands the business.

MR. GARMON: Win?

MR. WEBER: I was just responding to the dominant manufacturer theory which I knew you were going to get me on here. First of all, let's recognize that category management is a retailer-driven process. Therefore, the retailer, the category manager, is in fact the decision maker, and that category manager has performance measures that are sales, profit, ROI, whatever those measures may be.

If a category manager delegates the decision authority of that category to a supplier, they are going to be relatively ineffective and ultimately make the wrong business decisions because they'll be making decisions in favor of the supplier as opposed to the consumer and so forth.

I think it's important, though, to recognize that in any selling situation, both sides at the buyer's desk carry biases into that equation. Every supplier representative walking into a category manager's office has a paycheck that has the name on that paycheck of their company, and the buyer is sitting there with their paycheck.

That's what the negotiation planning process is all about. It is recognized that there are biases. That's why it's important, as I think as Don mentioned, to teach category managers to listen to all suppliers. You cut through those biases so, hopefully, as a retailer, you're making the right business decision for the right reasons. So I am less concerned about the dominance issue as long as I've trained category managers to manage the business well.

I would also admit that there are certain retailers I've heard of in the industry who hand a category over to a supplier and say, Manage this for me. That is not effective business management from a retailer standpoint, and I think it's very dangerous for a retailer to pursue that course.

MR. GARMON: Bob?

MR. REYNOLDS: Most of what we've talked about so far has been talked about from a single brand perspective. But the reality is that the people who function as a category management representative are often brokers, who will be dealing across several lines and have built trust with the retailer across several lines, and may in certain circumstances be even officed for a certain portion of the week within that retailer account situation.

They apply a lot of resources against this process, and so let's don't just all think in terms of its the P&G guy or the Coke guy who is a corporate representative of those firms that plays that function. Very often it's a broker kind of a situation.

The other thing that I always tell my clients who are interested in marketing effectively in this business is that they have got to know the retail part of the business. They have to know their lines better than the retailer does in order for them to be effective against their categories.

So everybody in order to be effectively marketing their own products -- should be effectively vying to be the category captain. If they have that mindset, whether they actually get into that position, they're going to be better off in marketing their own products.

MR. GARMON: Bob Steiner.

MR. STEINER: I would like to put this, if it's not out of order, in a little bit of a historical context. Before there was category management, you read a lot about channel partnerships which were individual partnerships between a manufacturer and a retailer and really pioneered by Wal-Mart and Procter & Gamble in 1985.

And there was the wonderful idea behind this, a revolutionary idea concerning relationships. If the manufacturer and retailer could get together, trust each other, and analyze the whole cost structure and the channels of distribution, that in that fashion they might be able to take costs out of the whole channel from the manufacturer to the wholesaler to the retailer.

That was a great idea because it wasn't integration. It wasn't franchising. It wasn't vertical restraints. It was a new concept. And so you saw literally hundreds of these channel partnerships developed, and a lot of them were very successful in doing this and reducing cost.

But then I guess there came to be too many of these partnerships. I know K-Mart had over 300. VF Corporation had over 300, and when Procter went to category management from brand management I think that helped. At the same time the Food Marketing Institute was trying to help the supermarket industry recapture market share and had their efficient consumer response model, and this model also was based on categories.

And so now you had these individual partnerships, vertical partnerships morphing into a whole category vertical relationship. In the FMI write-ups, you see, as Win said, they're extremely complex and very driven by data and systems. It's very hard to operate them, and you can see that in practice. But they all relied on this vertical relationship and the fact that the manufacturer could bring to the party a lot of things that the retailer couldn't, and vice versa, so it made a good marriage.

But then what concerned me, there is this efficiency, and you can read the trade press and see a lot of examples, I don't know if they're all true, all over the world of real savings that were extracted in the channels of distribution. But you also seem to have in some cases, I know not in all cases, a very worrisome structure in which you have a category captain from a dominant firm. And category captains must be valuable because they're being auctioned off recently, and you read about that in the trade press.

The category captain may be making decisions on the planogram and on what SKUs will be selected, and since a Procter & Gamble or a General Mills can bring to bear a lot of really expert people, well educated in consumer behavior, et cetera, and a small number of categories, and the retailer has 250, if he's a supermarket, different categories, and his category manager who interfaces with him isn't going to be as well informed. He can't possibly be. He's got too many to handle.

MR. GARMON: We'll talk about the possible use of category captains excluding others after the video.

I wanted to put out one more question before we go to the video, and that is sort of relating category management back to what we've been talking about these past two days, slotting allowances.

What's the relationship between category management and category captains and slotting allowances? Particularly for Don and Kevin, how do you choose which products to take? Is that primarily based on your category management processes, or is it primarily through the use of slotting allowances, and what relationship do slotting allowances have with category management?

MR. HADE: I'll take that one. First of all again, I think it's going to depend on the company. Speaking about our company, again as you've heard us say in a couple of the other sessions, we're an independent grocer who has to compete against large companies. We do that by offering variety. And offering the products our consumers want.

Again, in many ways, we like to use our size to an advantage. By being smaller we can get to know our consumers on a more intimate basis. I can tell you the selection for products at Ukrop's Supermarkets is not driven by slotting allowance. It's driven by what we think our consumers want to purchase.

I think -- again as I mentioned in some of my opening remarks -- we have a tremendous amount of data available at our fingertips from scan data, but also understanding our household purchase data, it is very important to us what our top decile customers are buying.

We do not want to lose those shopping baskets, and we may elect to carry an item, say in the cereal set, that on paper isn't the best deal, just to look to the cereal category. But when you go and run a cross reference on that particular SKU and find out that of those few boxes you're selling, they're in some of your better customers' baskets, that's not something we want to take off the shelf because we don't want to send them somewhere else.

I think the basis for making decisions is that our company is not driven by whether someone's going to pay us a fee to come into our store. Generally speaking anyway, we're not a company that views those fees as a profit. Our charges in that area are pretty small and really are set up to just cover our expenses to make the changes, so that would probably again favor our decision in that area.

But again our basis for carrying products is what we think we'll sell in our marketplace.

MR. GARMON: Don, what's the relationship between slotting allowances and category management at Stop & Shop?

MR. SUSSMAN: Well, first of all we don't use category captains so that's really a non-issue for us. But first of all our category management is -- we have teams. There's a category manager, and they have a buyer or multiple buyers, depending on the portfolio that they're managing, and so they operate as a team.

At this point we've written category plans for virtually every category. We've been in it long enough so we're in the refresh side for virtually the first time out. We have a strategic plan for that category, and as new products are offered to us, depending on how that item matches our plan, it's up to the buyer and category manager to take the presentation, and then bring it to the buying committee with your own recommendations.

And the category manager has the ability to override the buying committee because we think ultimately it's the category manager that needs to make these decisions.

I'll give you an example. A category plan, say for paper, can center around larger sizes because they're more efficient to handle in the store, and we also pantry-load the customer, meaning we get a chance to sell them more at a time. So with that we might be bringing in large sizes. Large sizes that are usually club store packs usually don't have slotting fees.

If that category manager wants to bring those items in as part of their plan, they bring it to the buying committee, state their case, and they do have the ability to override the buying committee. The buying committee is made up of their peers. It's other buyers and category managers who just challenge each other.

So ultimately slotting for Stop & Shop is an input into the process. It's not ignored, but it's not the only determinant of getting in or out. Items that have slotting are often rejected. Items without slotting can be accepted, but obviously we want slotting so we try to reward people that give it to us.

MR. GARMON: One -- Bart.

MR. WEITZ: One way of looking at this might be this. First of all, category management I think is much more exclusive than slotting allowances in terms of the products that it deals with. Slotting allowances, as we talked about, are mostly related to new products, although we've indicated that there are other allowances for existing products.

But I think conceptually one way of looking at this might be that they're both trying to sort of accomplish the same thing in determining what SKUs you're going to stock in the store. But category management is a much more proactive approach towards it, where slotting allowances conceptually more of a market-driven mechanism.

If you pay me more, I'll put you in the store, and so you're sort of allowing different bidders to bid for that space, as opposed to you figuring out what the space ought to be, how the space ought to be allocated more appropriately.

MR. WEBER: I look at category management on a much broader scale. I start with the strategic plan of the retailer. Within the strategic plan of the retailer there's a market position that comes out of their marketing plan, whether it be Costco that says they're going to have a limited assortment, larger sizes or what have you.

There's a framework, and the strategic planning purpose is to guide the allocation of resources across the business. We have the luxury today of driving this type of process down deeper into the business. Don mentioned category plans at Stop & Shop. Well, the component of those plans, he has category roles, and a signature or a priority category may state its strategy as a broad assortment for a lot of good reasons.

By the time he gets down into a fill-in category -- shoe polish may be one brand -- they develop decision guidelines by category role type that provides a framework for the allocation of resources against the business. That means the category manager then is going to be working within that framework which means the breadth of variety, the amount of promotion, the pricing strategy, the space management strategies will differ across that store based on the relative importance or lack of importance of that category to the total. The retailer today is trying to get a much higher return on one of their most key assets, which is the store, which is critically important, the key asset next to the consumer obviously.

So there's a framework here, where this is by no means an open discussion that suggests I can do this or do that, an assortment. The category managers are working within a relatively tight framework that they've helped develop and that has been approved by the senior executives.

MR. REYNOLDS: Chris, one point here? I understand there are certain categories that retailers do give over entirely to an outside vendor, kitchen gadgets for instance. It's a rack jobber that comes in and decides what is going to go on the rack and services it, towels, some candy kinds of things, et cetera, magazines.

MR. GARMON: On that point I want to leave enough time for a discussion of the antitrust implications of category captains. I think the video -- I haven't seen it, as much as I know about it -- goes to that point. So why don't we show the video now, and then I'll come back to Greg and Bob again. And we'll talk about some of the antitrust implications of category management.

(Whereupon, the videotape was then played.)

MR. GARMON: That was sort of an extreme example. Professor Gundlach, you had a comment.

MR. GUNDLACH: The comment really regards an earlier discussion. I think it's important to get on the table, and perhaps some of the people can respond to it, is this: What is the private label mix in here? We've been talking about decisions regarding the entire category, and the objectivity surrounding that, and the use of a category captain to help in that process.

How does that relate to the store brands? Are they considered in this process? Are they off the table, on the table? Perhaps someone could illuminate on that.

MR. SUSSMAN: They're very central to our category plans. At Stop & Shop the category manager has ownership of the private label within their category. It's up to them to figure out the role that private label is going to play within the overarching private label guidelines that we have, but also to increase the variety, decrease the variety. It could well be that we have many price brands that are less profitable to us than our private label, and some of those will drop in order to promote our private label.

So it's very central to our category plans, and they're a major element of our plans.

MR. WEBER: What Don is saying is not just Stop & Shop. All of our consultants we compete against, we all suggest very strongly that private label be a part of the total planning process responsibility of the category manager. And if it's not, then you're really not in category management.

MR. SUSSMAN: There are times when our private label actually turns out to be on an A, B, C basis less profitable, and we drop it. It doesn't have a role in that plan. There are other times when, again, we want to promote it and grow it as bigger percent of our total.

MR. ANTALICS: Before we move on, whoever represents the party on the tape, if you won't mind spending a few minutes with me afterwards.

MR. WEBER: They're all wearing stripes.

MR. ANTALICS: I thought what we would do to start off the second part of our discussion here, and maybe if we can hear from Scott and then Pam, I don't care in which order, some of your thoughts on what you've heard. We've heard some of the benefits up to now of category management. I am wondering if you had any other experiences.

MR. HANNAH: Yes, I'll give you a very direct experience. We lost distribution, I made notes -- in Cincinnati, Denver, Salt Lake City, and Los Angeles -- because we did not have a broker that was strong enough representing us on category management. The brokers, as Bob Reynolds has said, the sales reps are the ones that do the category planning, not the retailers, in these markets. They make recommendations -- sorry to disagree with Winston again but it's not retailer driven.

MR. WEBER: You're just building our counterpoint argument.

MR. HANNAH: Exactly. It's not retailer driven. The retailer might have overall broad goals, but the actual schematics, digital shelving, everything, are with the big brokers, big sales agents. What happened in our case and what does work if you're careful, let's say Safeway for example, they'll go to the strongest frozen vegetable broker and make him responsible for the whole planogram on frozen vegetables.

He'll go to the other broker representing potatoes, french fries, make him manager for that category, and what you have is mutually assured destruction. If these guys aren't fair the retailer won't buy it, but also if they try to screw the other guy they're going to get hosed themselves on their open products, if you follow.

What happened in the markets where we lost was we did not have a broker that was involved in category management, and we were like the little companies that got kicked out on the slide presentation. So category management is very valuable and I think a real asset, but you have to be careful where you sit in the power struggle of things. Thank you.

MR. WEBER: Can I counterpoint just for the heck of it? As we consult with our manufacturer clients, the broker is the extension of their selling arm, and it is their responsibility to select those brokers or those sales organizations that can meet the requirements of the customers or potential customers.

If a broker does not understand category management and doesn't know how to work within it, it's not the retailer's fault. It's the supplier, and that's their responsibility.

MR. ANTALICS: Pam?

MS. MILLS: It's been my experience with category managers that we're never asked our opinion. That's not even part of the program. What I found in our market area is the category managers are all part of their full program with the slotting fee monies, where they're basically a labor force for the chain store.

For instance, Safeway came out with a big reset program where they brought in these new display racks. And in these display racks they implemented or placed within the most valuable real estate on that display rack, where it's at eye level for the consumer on the right and left-hand side of this four by three schematic.

And that one side is the area that my product is usually placed on, so I lost two whole rows at eye level. The competitor was able to reduce my shelf space to I call it unlivable living conditions and unlivable space. Basically they put together the reset plan based upon space to sales, based upon your sales data, all sales data, put in their space program, take it to the buyer, and they're like, It's a go, and the next thing I know, I got this reset schedule, and I'm going, What?

And it takes months and months to get anything reversed, corrected, changed. What I come back with is photos of the category showing that it's brand X that's driving the category so to speak, as they say.

When I come back to my photos, their space has no product on the shelves whatsoever, so how can they be driving this category? They're selling air, and I'm left with this inches of unlivable space, and the category captain basically can put a new rack in, take a new rack out, change a rack to another location because they're considered God.

MR. ANTALICS: So in your case the category captain, it's the dominant manufacturer in your category?

MS. MILLS: Correct.

MR. ANTALICS: And what access do you have to the retailer then, once the retailer decides to go with the category captains's recommendation or plan?

MS. MILLS: I just fit the schedule. It's done. It's not up for negotiation whatsoever. After that then I have to start bringing my numbers in and showing how brand X is not doing a very good job, and so it may take maybe a year later, but that's all lost sales, lost.

MR. ANTALICS: Let me just open up a question to the whole group here. What's your experience as to how often decisions are made in a product group by one particular company, by the dominant company, for example?

MR. HADE: I'll take that. At Ukrop's it's never done by one company.

MR. ANTALICS: Give us an example. Will you call in all of the companies in a category or a select few?

MR. HADE: I'm discouraged at what Pam is sharing because we would not do that at our company that way. I'll tell you it's a tough decision. A category manager, that's a tough job because you're a hero to one person and you're a bum to three other people almost every day, because you have to make touch decisions.

However, you run into situations, like we saw on the video, where at some point it doesn't make sense to maybe carry six lines. Maybe you need to cut back to five. That's from a SKU rationalization standpoint, but any time we're going to be looking at a reset in a particular category, we're not going to do it with half the people involved.

Even if it involves having a tough heart-to-heart discussion with a company, we might say, Listen we're reevaluating this business, and one of the things we've got here is we're seeing that X number of your products fall in the bottom 20 percent of the movement here, and we're having a hard time justifying you staying in this particular segment of the business. Can you tell us, if you were us, why we should keep you in this category. And we give that vendor the opportunity to make a compelling argument in that particular area.

Ultimately they may stay, they may go. But we feel it's important to have a dialogue with everyone involved in the process when we make a change.

MR. ANTALICS: Don?

MR. SUSSMAN: I'm pretty cynical by nature, and I think most people act in their best interest. If you ask a vendor to do an analysis for you, they usually have the end state in mind and work backwards, and very few large manufacturers will cut their open space back and tell you you should keep smaller people on the shelf because they have legitimate variety. And very few small people will say, We're really not adding anything to the category and you're out of stock on your fast mover so throw us out. So that's why we have to make those decisions.

MR. ANTALICS: Win, how about your experience? How often do you see one dominant manufacturer making the decisions for the whole category?

MR. WEBER: I've never see it in the U.S., Asia, Latin America or Europe. That doesn't mean it doesn't happen on the exception basis, because I think in this industry, a lot of things can happen on the exception basis.

I was listening to you talk, Pam, and I was thinking that could have occurred, that situation, without category management and before category management. We had space management and space management technology before category management started rolling in, and the same situation of getting the technology to a supplier to work with you could have occurred.

So it was behavior that could have been pre- or during category management, and in a small percentage of times, hopefully, those are the behaviors of the exception rather than the norm in the industry. I would hate to see us thinking that those exceptions are normal behavior.

I think there's another thing to take into consideration which is an industry problem. That is the store execution issue in the grocery business today, the part-time labor issue. The turnover issue, the execution at store level is not the best, even with the best retailers today. It's a real bear.

And if you're sitting there and a category manager commits to a given planogram of a given assortment and a given position of products and facings, boy, if you're 80 percent there in 80 percent of your stores, you're on the high end in many instances. You guys may correct me, but it's a real tough one right now. That's why there's studies going on in the industry, both industry sponsored and independent, as to how we can work on the execution piece of the business.

So there is an issue out there that exists to varying degrees, but common across the industry, on store execution.

MR. ANTALICS: Greg, you had something?

MR. GUNDLACH: We've been talking about the objectivity surrounding category management and the fact that retailers will often consult several manufacturers. Just one query, how often do the manufacturers come up with the same result?

In other words, do the same recommendations come from different manufacturers, or are there different things happening and different data being utilized to make or craft those decisions?

MR. ANTALICS: Kevin, what do you see when your various reps come into the store? Do they come up with the same plan or a similar plan?

MR. HADE: It varies by category and I think it speaks a little bit to the working relationship of the players involved. If we've got a particular category where the five vendors involved have known each other for many years and have a good working relationship, they can look at the data and see the same thing, that these five or six products are going to have to go to make room for something else. And there's not a lot of hardship over that type of decision.

On every occasion do they always match up? Of course not. Every one's out there fighting for their own best interest a little bit, and I think that's where a good category manager has to step in and look at the recommendations across the board and weigh the arguments presented to them and make a decision that's in the best interest of the retailer and ultimately of the consumer.

One of the other questions we had from the panel today was, How do you make decisions on what products to sell? Again, at Ukrop Supermarkets our motivating force is to put products on the shelf that our consumers in our market area want to buy, and that's what we try to convey to our vendors and that's what we're collectively trying to do. We have to make tough decisions every day.

We do it, and we go, and we move from that point, but we encourage that type of teamwork, but I think it's Pollyannish to think that everybody is going to present the same plan. I don't think it's going to come out that way.

MR. ANTALICS: Do the vendor reps negotiate among themselves? Are there discussions among the vendors?

MR. HADE: I wouldn't call it discussions. Again how our organization would work, let's take a cereals set for example. If we decided that it was time to take a look at the planograms in that particular area, our category manager has a person that works for Ukrop's who kind of sits in with that group and ultimately will help with the execution of the planogram changes. So we'll have representation from Ukrop's Supermarket as well as representation from all the vendors involved in that set.

Someone mentioned private label earlier. Also our person is there representing our interest because we're a vendor too. We're trying to sell product on the shelf as well, and I think there is input. We'll look at the data. There will be some discussion on -- everyone has an opportunity to say, Hey, we realize that we've got to create this much space in this particular area, what's got to come out of the set?

And there's give and take there, and then ultimately when we've reach an accord, that is presented to the category management, and that particular person either approves or disapproves of how that works.

In some cases they don't have all the information they probably need. Again I come back to some of the instances I mentioned earlier. I'll give you a good example. Kellogg's may even be telling us, We want you to stop selling our nine ounce sizes of corn flakes, we're putting all our money this year into larger sizes.

We have a large population of elderly consumers who like small sizes, even if they have to pay more per ounce, and we don't want to take them off the shelf because when we do, they complain, and they've been some of our best lifelong customers, and here it is the actual vendor is telling us, we don't want you to sell our product. In some cases we decide we still want to because our consumers know it's available. We should try to get it for them. I think that's an opportunity we all have to face.

MR. ANTALICS: Well, mechanically how does this work? Will the vendors come together with a plan? Will you get them all in the same room, or are these individual discussions? How does that work?

MR. HADE: I think it would probably be more like what you have here. We announce that we're going to take a look at this particular opportunity. Everyone is given the same amount of information. Everyone is given an opportunity to provide their input based on the information we've given them on how they would do that.

And there may be some general dialogue once everyone's provided an individual opinion amongst the team of all the vendors and also the representation from Ukrop's. Then there would be some type of compromise or formal agreement, the final planogram recommendation so to speak, and then that would go to the category manager for his or her approval.

MR. ANTALICS: But this is everybody sitting down in the same room just talking it through?

MR. HADE: It could potentially be that way, yes.

MR. ANTALICS: I'm sorry, Pam, you have something?

MS. MILLS: I have a real life story to tell you guys. When we got reset recently in one of our major chain stores, we got the schematic, the dates, okay? Well, simultaneously another chain store was resetting at the same time-- and who knows if that was planned or not -- but in one of our chain stores, we couldn't get our people there at the scheduled time, at the scheduled date. So that was another problem.

But in this one chain I finally got an appointment with my buyer to discuss with him what were the ramifications of the reset to our company, and what it did to our sales, and what it did to reversing our sales to a point where it wasn't cost effective to take the product to market. But it took me a month to get in to see him.

I took in photos. I took in documentation. I took in how much basically linear square footage we were given, which was less than 10 percent,. and brand X had all the space. And he goes, Well, you know what, you call up your category captain and you have him discuss this with you and see what you guys can work out.

So he calls me up and he says, Okay, he goes, Let's meet at this store, which is an hour away, at three a.m. And I'm like, Three a.m.?

MR. ANTALICS: You said meet with the category captain, and this is your competitor?

MS. MILLS: Yes, to discuss our space and at three a.m. I go, Well, how about six. He goes, No, no, no, my schedule is too busy. I can't make it at six, and he goes -- well, I go, How about this day. And he's like, No, no, no, if I can't get this date it's going to be like in two or three more weeks, and I'm thinking this guy wants to drag this out.

So finally I go, I'll get back to you on that. So I'm thinking to myself later it's like, Okay, if I don't make this time, I'm not going to get what I want, so, okay, I'll get to that store. I called him back, I'll be there at three a.m. The day before the meeting he calls, Oh, I can make it at five a.m. and I have to drive an hour so imagine what time I'm getting up.

So we go to the store. He's got his sales rep there. I've got my sales rep with me. It's an end cap display, and they had other products lined up on the wall there which were covering up my inches. I'm like, What's this, why is this product covering up my product? He goes, Well, I don't know about that. He goes, Well, we're going to put in another end display.

And he goes, What is it exactly that you want? I want these two top shelves back, and I want to come all the way out to the end on a four by three. He goes, Can't do that. I go, Why not? He goes, Just can't do that. I go, Well, if you're not going to give me back the two top shelves and then we come back all the way to the end, then let's not talk any further. He goes, Fine, then.

So then I go, Okay let's go to another store, and he goes, Nope, we can't agree now, so why bother. I go, Okay, I'll take my digital camera with me and I'll take pictures at that next store. He didn't go. We went to those stores. They had two end cap displays. They had absolutely no product on them, but my little product on my little inches was full to the brim because we went there every day to get those minimal sales, okay?

So I had all these digital photos because he was too lazy to go. He probably knew there wasn't product on the shelves. And he's driving the category, selling air, so anyway I get back the buyer. I go, Buyer, we just can't agree. I go, I think we're going to have sit down and talk. And he goes, Okay, I'll get him on the phone and see when we can all get together.

So, okay, go in there. We all get together, guess what? My category captain brought in his big boss to deal with me, and so it was like the two of them, brand X, me and my buyer, so I basically told them they had placed me in unlivable space. The category captain does not want to give me this much space, this is what it's done to my sales.

Obviously from the pictures they're selling air, not really driving the category, so can we make some changes, and at that time we agreed. We agreed to get the two top shelves back for me, and then one of my giving back to them was, Well, you can have the front corner representation.

I just wanted to have liveable space. I understand the heavy hitter. They can do what they need, and they were just having a fit. And I'm like, What is it with you? Why can't I have liveable space when you guys have all this that you're not even getting the product to market on, what is your problem?

And they're like, This is our space and we just don't want to give it up, and then so it started getting really heated. So then my buyer says, Okay, she's going to get these two top shelves, and you guys get the front facing on the front corner, and we all agreed. Okay.

Then it came down to implementing the program. I mean, for us we've been in a position where --

MR. ANTALICS: Before you get into the implementation, Pam, let me ask Win a question. Win just --

MR. WEBER: I have five answers.

MR. ANTALICS: You told me everyone has access to the retailer in your experience. What's your experience been with respect to negotiations among vendors as to what the appropriate category ought to look like?

MR. WEBER: Well, there are a couple issues here. Number 1, it's almost to the retailer's disadvantage to put two suppliers in a room to develop a category plan because that can negate the negotiating leverage the retailer has on one supplier versus the other.

You're not going to handle -- you're not going to share trade allowances because that is a point of negotiation, so a retailer is disadvantaged by putting two suppliers in a room.

Second, in terms of new products, seldom will one supplier sit in a room and share the new product information with their peers in the category, for all obvious reasons. So to me this whole issue of two suppliers sitting in a room, before we get to the story, doesn't happen with any retailer of any substance or size or ethical value whatsoever in this industry.

I was listening to your story, and I started as a retail salesman in this business, and I've gone through exactly what you've gone through. I've negotiated the shelf. I've been hammered. I've had bosses. I've been there three in the morning. That was 1963. Things have changed.

And hopefully what you're explaining is a very small percentage of a total today because that was the behavior in the industry. I know like at Stop & Shop, and most other retailers today, your space management groups have tight control, and they're the ones that are actually ultimately making that decision; is that correct?

MR. SUSSMAN: That's correct.

MR. WEBER: I apologize for speaking for you.

MR. SUSSMAN: That's correct. We don't have our vendors deciding what space to utilize in our store. That's our decision. When we actually go to a rollout of a planogram and the vendors are participating, I won't say that they don't ever get to a store where the planogram doesn't exactly fit the physical constraints of that store, and they ask people whether there's jockeying gone on.

But for the most part our vendors are professional and they act in a professional manner. I guess that's not always true in every vendor, but we're responsible for the planogram. We're responsible for the space. It's our space. We built the store. We're not giving up the control to anybody.

MR. ANTALICS: Kevin, let me ask you: Do the category captains come in with recommended pricing and promotions in your experience?

MR. HADE: In terms of just for their products or all products?

MR. ANTALICS: In any respect.

MR. HADE: Let me answer that question and I'll also speak a little bit to what Win was talking about. I disagree with the things he was saying about new products, et cetera. I want to make it clear generally what happens in our particular situation. We've talked about a collaborative group getting together. That's after each has individually met with a category manager and we've decided which products we think can sell in our supermarket.

While we may have a general idea what needs to come out, and we may share that with them, we give them an opportunity to share some feedback and come up with a different compromise, so we're not putting anybody at odds well in advance of when the product's going on the shelf. It's already been said, this is going in, so no one is at a disadvantage in that particular standpoint.

When our vendors are together, we're not talking about pricing. Again, all of our pricing and trade promotion, that's all done individually with our vendors meeting with our category manager, whether it's ad planning for the upcoming period, and our two primary vehicles of advertising are a monthly program and a weekly program in which we encourage our vendors to participate.

But what we're really talking about when we're working on shelf planogram sets, et cetera, is to speak just primarily to where the products go, et cetera. There's no discussion about what the GP is on this particular item, et cetera, and from that standpoint and motivation of what the retail price should be across this particular area, et cetera.

We have that information at the category management level, and certainly when the presentation is made back to our category manager, they're going to take that into consideration. We are going to want to take advantage of an appropriate eye level spot. We're also going to want to place private label in a favorable location.

All those factors come into play before the final agreement is done. And really the other piece is an input phase, and I think that's an important part, too. We view our vendors no differently really from our customers. We're a golden rule company. We want to treat our vendors like we ourselves would like to personally be treated. That may be again pie in the sky, but we try to make that happen.

MR. ANTALICS: I want to get to Bob and then Don here with a comment on that.

MR. STEINER: I think compared to slotting, which we've been talking about, the opportunity in category management for efficiencies is much greater, and really that is one of key purposes of it. Also the possibilities of collusion because of the structure are much greater.

Whether they happen or not, I don't know, but it seems to me that when you read about this in the trade press, you read two things. One is that the big mantra is trust, that all people at all levels have to trust each other about shared information, not giving it away.

This is information that, in the old days when I was at an industry meeting and anybody talked about price, our attorney would get his hand up and say, You can't talk about price at an industry meeting. But now we have this shared information, which is the way that you get a lot of these efficiencies.

And it's the way that, when you have one manufacturer and one retailer, probably can't be abused. But when the structure is that you have a category captain, which as I said is frequently auctioned off and is generally in the control of in many cases the large manufacturer then several things happen. First of all, I've read about this, and there are people on the firing line that have much more than firsthand information, but you read the small manufacturer that says, I have enough trouble getting my items sold to this big chain without having to go through the category captain who's my bigger competitor and who doesn't want my stuff out there. This is just another barrier to the entry as far as I see it.

You also have the possibility that as part of his responsibility, in at least recommending a fairly comprehensive category plan that includes the SKUs that are carried, includes pricing, includes planogram space allowances, the category captain, to do his job right for that retailer, has got to have a lot of information from his competitors, and I would say probably more information than we ever were able to get in the past.

I don't know how that plays out in different cases, but you can see the possibility of mischief in this situation. Furthermore, the category captain's domain can be very broad. He can be the captain over a number of competing retailers, and so you would wonder from a retailer's point of view, What about this shared information? What about the possibility of collusion in some form between retailers through the enabling of the category captain. What about vertical restraints that could possibly be anti-competitive?

It almost can be made to sound like a corporate state or something like that, where you have all the manufacturers getting together through one manufacturer. And I'm sure it doesn't happen like that all the time, but there is the possibility of that.

You also see something else that is potentially troubling. You read the trade press, and you are see you're going to get rid of this adversarial relationship that has always bedevilled manufacturer-retailer relationships. We're going to replace it with a relationship that is a cooperative. Again that has many benefits from the point of view of efficiency, because to get rid of redundant kinds of costs in the distribution channel, to work together on a just in time basis, and all those things, you can see that if it's too adversarial you can't get the benefit of that.

On the other hand, if you're in too-close cahoots and you give up all vertical competition, that could be a problem, too. So I think it's a big world, and we know from what we've heard yesterday and today, there are many different examples of all kinds of different structures.

But it seems to me it's something that the Commission has got to keep its eye on. It's also something that may lead if done right to tremendous efficiencies that can't be generated any other way.

MR. WEBER: Can I respectfully agree?

MR. ANTALICS: I think Don had a comment first, and then I'll get to you right after that. Let me just add one additional question for you so you can consider that in your answer too.

MR. SUSSMAN: Lose my thought right now.

MR. ANTALICS: How often do you hear from your category captain, This is a good plan to use these recommendations, this is what the retailer down the street is going to be doing as well?

MR. SUSSMAN: That's not something -- quite honestly I'm not close enough to the -- first of all, we don't have captains or partners, so the question is how much feedback do we get from the vendors. I'm not at those meetings on a regular bases. I couldn't tell you, so I really don't know. I couldn't give you an answer to that.

The point I was going to make, though, is that category management is not a fixed either-in-or-out position. It's very much an evolutionary way of doing business. It's a set of guidelines and principles that's constantly changing. It's evolving at each of our own companies, let alone as an industry, and it will be different years from now or even next year than it is today.

And category management does not guarantee against bad management. There is no end to the horror stories that we can have of bad management out there. They existed before. Unfortunately they'll exist in the future. I think some of what we're talking about is throwing out the baby with the bath water with category management.

We think it's a superior way of doing business than we did before business, but we also know it will change and it won't be the way we do business in the future. Nothing ever stays the same.

Part of the problem in the film we saw was that there was a buyer who is given a change of title to category manager and expected to do new work. It doesn't work. You've got to train people. You have to give them information, resources and the ability to make good decisions.

You can't just say, One day you're a buyer, next day you're a category manager, because that's what happens. They go to a vendor and say, Help me, I don't know how to do this myself.

MR. ANTALICS: I wanted to get to Win, and then I wanted to hear a little bit from our attorneys who so far we've kept muzzled, so they can give us some ideas on how to stay out of trouble here.

MR. WEBER: I think the efficiency argument is a very strong argument and support that wholeheartedly. If we look at the U.S. economy right now, and look at the fact of collaboration across industries, whether it be auto or computer or what have you this has been one of the key factors driving our economy at the level it is.

I'm not an economist so don't throw theories at me, but the reality is efficiencies working together has driven a lot of cost out of the U.S. system right now.

I wanted to clarify one thing, and that is the issue of auction. We're acutely aware of maybe two or three retailers who do in fact auction off the category captain position where the supplier has to pay for it.

That is a rare, rare case in terms of paying for it. The criteria is usually more like the criteria that's been discussed earlier in terms of how one is selected, because auctioning off may not give you the right relationship with the right supplier to truly serve the consumer, and that's a key issue.

In terms of sharing, our retailer clients, and those who are not our clients that we know, do not like to be working with a category captain or a team that also is working with a competitor. They feel it's actually a conflict from the manufacturer side in terms of working with both retailers at a strategic level so closely.

The only time that we end up with the same team or same group working with competing retailers is when it's inefficient for the supplier, because there's not enough work for one team just to work with one retailer, and just so the economies of the structure of the supplier result in potential conflict where there is a one supplier team working with two competing retailers. That can happen.

In terms of sharing of information, if any supplier walks into any retailer captain and is sharing information from a competing retailer, that category captain is not going to be a category captain because that category captain, you know, is sharing your information with the competitor, and there is a natural human safeguard in this whole process.

MR. ANTALICS: Bart?

MR. WEITZ: I want to go back to a point that Mr. Sussman made. I think one has to be cynical about this in the sense that the reason that allowing one manufacturer to manage the category is not in the retailer's best interest, is because that one manufacturer is going to be biased. I think that the case that Ms. Mills brought up was very salient about how this person that's the dominant manufacturer in tortillas actually might be doing something that's very dysfunctional for the retail chain.

And my feeling, although this doesn't really help your day-to-day business, is that ultimately that category manager is going to recognize that that dominant tortilla manufacturer is not acting in the store's best interest, and that dominant manufacturer will have much less influence over time. I mean, you'll win out because you'll show them the pictures.

I think it's unfortunate it's going to take maybe a year for that to happen from your point of view, but the system will work out.

MR. ANTALICS: Let me ask --

MS. MILLS: May I say something real quick?

MR. ANTALICS: Sure, real quick.

MS. MILLS: I must say I haven't been reset yet, and it's still, what? It's been months now.

MR. ANTALICS: Let me throw this out to Irv and Jeff and Chris. Having heard all of this, can you give us any of your thoughts, first as to maybe some bright lines as to where people ought to be, which side they ought to be on just to stay in the clear? And maybe give us some idea as to some of the tensions you've seen in dealing with clients, where you see them coming close to the line.

MR. MACAVOY: I think some of the tensions have been well identified by the prior speakers. It's been mentioned a couple times that there is a tension here of communication and trust and opportunity for mischief, as one person put it.

I guess the first takeaway I have is the great challenge of training. Don mentioned how foolish it would be to just throw somebody into a new job responsibility and say, Here do it, and some of you may have seen the tape and said, Gee, that's crazy, that could never happen, and then maybe now you're thinking, Gee maybe it could, after hearing some of the discussion.

There is a great challenge here of legal training. Maybe the first takeaway or advice I would give people out of this is when you are doing your antitrust training make sure you have the category managers there. They're in that key intersection of the company.

MR. ANTALICS: Irv?

MR. SCHER: I've counseled in this area. I don't think there's any reported litigation. I haven't been involved in any litigation. And it's been on the vendor side, and I always make it clear to my client, my advice first and foremost is that what you're doing is only recommending. The retailer must make the decision in each of these areas. That's the number 1 rule.

The second rule is the confidentiality of the information that you're giving back and forth to that retailer. As Win said, if you're a retailer and find out from that vendor information concerning your competitor, you're not going to want that vendor to be your category manager anymore.

Third, I counsel my clients not to seek any information concerning the retailer's plans concerning the retail prices and promotions of its competitors. That's information that we shouldn't have in advance, no matter where we obtain it. We certainty aren't going to allow them to obtain it from their competitors, and they shouldn't do that indirectly by obtaining it from the retailer.

Next, no joint activities, no co-captaincy. If the retailer wants to get information from two suppliers, wants to have two category captains, he should do that separately. That should be the retailer's decision, but we're going to do this one-on-one.

Next, no recommendations to exclude another brand. As has been made clear here during this conversation, it's usually the largest company that becomes the category captain, and sometimes that can be a dominant company in a particular product category, and it's just an absolute no-no to make a recommendation that excludes another brand.

Now, all of this becomes touchy when you factor in private label. I've been hearing that private label is part of the plan. It's the natural feeling of the vendor that he doesn't want that retailer to be in private label. If the retailer is going to be in private label, we would like that retailer's price to be as high as possible. Maybe we even want to coordinate our promotional activities.

Well, that retailer has become a competitor, and that becomes a very touchy, sensitive area for the vendor, and frankly it's a difficult one to counsel on, and the way I try to do it is to say, Well, that retailer as a private label seller is the same as another brand manufacturer, and you've got to handle it the same way, very difficult.

MR. ANTALICS: Jeff, any thoughts?

MR. SCHMIDT: Mike, my thought is really we can make this more complicated than I think it really is. It seems to me that all the antitrust concepts that we saw on the video, that Irv and Chris have shared, apply whether we're talking about category management or not. There is no category management exception to the antitrust laws, and I think if you recognize that, that these things are fairly straightforward.

I think you really have to be an extreme cynic, though, to think that the move toward category management, which at least in my experience is basically a move of the industry away from assertion-based strategy to fact-based strategy, doesn't reap enormous benefits for the industry and ultimately for the consumer.

And absolutely we have to do it within the parameters of the antitrust laws, but of course.

MR. ANTALICS: On that note -- okay, a final concluding comment. Go ahead.

MR. REYNOLDS: I've been troubled by the nature of the conversation, hearing that in fact a lot of people think about grocery stores as being food stores, or food and soap, and they're not. Grocers routinely give over large portions of their stores to a category captain with absolute or almost absolute control.

I made a little list if the retailers argue with me they certainly can -- but I'm thinking about greeting cards and books and magazines and kitchen gadgets and toys and pet toys and foil wrap and films and batteries and specialty foods and hosiery and sporting goods and continuity kind of promotions, where you choose the vendor and the vendor does in that space what they want to do once you've made the selection up-front, but day-to-day they make all the decisions.

MR. SUSSMAN: I would challenge some of those categories but I think the principle holds. You're right. Once we choose greeting cards, we might choose Hallmark to be our partner, but we might also insist on having some boutique spinners in the store as well, but within the Hallmark space they're deciding what cards go where. They manage that 100 percent. We don't try to tell them which St. Patrick Day's card to put in what pocket.

So I think the principle that you're talking about is correct, but some of those categories we are taking control of, magazines, books. We are now starting to decide what titles will go in one place on the rack ourselves, but I think still the vast majority of retailers in those categories are handing that off to somebody else.

MR. REYNOLDS: I was just guessing what it might be maybe, and it seems to me it may be 20 percent of the play space in the store is in categories like these.

MR. ANTALICS: Irv and then Chris and then we'll get Bob and any final concluding comments so we don't go over.

MR. SCHER: There may be a miscommunication here. If we're talking about rack jobbers, that's a middleman, a distributor who probably has everybody's product or all the products he wants to carry, and he is given that space or that category by the retailer such as in magazines and in some of the categories you've talked about.

MR. REYNOLDS: I wasn't thinking from an antitrust point of view. I was just thinking that the discussion in the broad sense has gone to individual slots on shelves, and retailers don't decide on every individual slot on the shelves. They sell sections as well.

MR. SCHER: But the issues that we've been talking about don't come about when you're dealing with -- the antitrust issues when you're dealing with a rack jobber.

MR. GARMON: Chris?

MR. MACAVOY: Just quickly. I associated myself with what Jeff Schmidt said on the other end. Done properly, legitimately, with antitrust training, category management can be and should be a terrific thing. It is very pro consumer. It's very efficient. And it would be a bad thing if somehow the takeaway from this program is that, hey, this is a hot area, let's stay out of it, particularly because done legitimately and properly it really has, as has been put here, the promise of getting some of the seat of the pants decision making out of the industry.

And to the extent slotting allowances are for some retailers, sort of a seat of pants, gee, it's there so I'll ask for it or it's there so I'll take it, category management can get that kind of decision-making out of the process, and hopefully for those people who are concerned about slotting allowances make it fade as an issue.

MR. ANTALICS: Bob?

MR. STEINER: One comment or one question on the last thing. You frequently see literature about people who are champions of category management against slotting fees and say that's a way to not translate consumer preferences into the SKUs that you carry. That distorts the process, so in a sense -- but they can be combined, too. But there is at least in the product category management area basically a thrust for efficiency, I think, which is good.

Another question I had on the list, Bob, that you had. I've read that Kraft in the freezer compartment and Phillips Morris in the tobacco area have long essentially been category captains who have pretty much complete control of SKUs.

Is that correct or not?

MR. ANTALICS: Scott?

MR. HANNAH: I can't address those companies directly, but I'm afraid we're getting off the track here and attacking category management. We're not. I think it's an excellent idea as a small manufacturer. The gentleman down here said the opportunity for mischief exists, and that's the key issue. Please don't forget that.

We're talking about antitrust issue, and if you're not a major player, or as Bob said if you don't have a major rep, a broker representing to you, you're going to be in big trouble, even if you have a top selling item. Why? Because that item will wind up behind the hinge in the freezer door cabinet. And the next time around, all of a sudden, sales are down as done sales go.

So please don't lose sight of what we're talking about here. A lot of that video was very, very true. Thank you.

MR. ANTALICS: Thank you everybody for your participation. I think we've learned a lot.

MR. GARMON: We'll meet back in ten minutes to start the next panel at three o'clock break here.

(A brief recess was taken.)

ROUNDTABLE 5: POLICY RECOMMENDATIONS.

PANEL 5 MODERATORS

DAVID BALTO, FTC

SUSAN DESANTI, FTC

PANEL 5 GUESTS

JEFF SCHMIDT (Attorney)

CHRIS MACAVOY (Attorney)

MARY SULLIVAN (Economist)

RICK WARREN-BOULTON (Economist)

BOB SKITOL (Attorney)

RICHARD STEUER (Attorney)

DAN SAVRIN (Attorney)

GREG GUNDLACH (Marketing Economist)

RON BLOCH (Attorney)

ALAN SILBERMAN (Attorney)

J. MARK GIDLEY (Attorney)

IRV SCHER (Attorney)

MR. BALTO: It's three o'clock, and we're ready to start our final panel. We really appreciate all the attention people have given us. Just a few housekeeping notes. A variety of you have seen this large package of documents in the back that looks like it's a lengthy paper by Steve Salop. It actually includes paper from Bob Skitol, including the petition from the Independent Baker's Association and a paper by Alan Silberman and a paper by Dan Savrin.

You can expect in the near future that the papers presented here will be posted on our web site. Sometime relatively soon we'll post the names of all the speakers, and hopefully within a few weeks we'll actually put a transcript up here.

Today our expert policy panel really is one of the most impressive groups of antitrust lawyers and economists I can imagine putting together. I have to wonder in putting together this workshop why it is that of the businessmen we called, a large number of them weren't able to make it, but the lawyers and economists all seemed to be readily able to make it. I don't understand this phenomena.

Anyway, we're under a very tight schedule. We have a set of questions for each of the speakers. Why don't we again begin by introducing ourselves starting with Mark Gidley.

MR. GIDLEY: Hi. Mark Gidley, White & Case Washington, D.C.

MR. BLOCH: Ron Bloch, McDermott, Will & Emory, Washington, D.C.

MR. GARMON: Again Chris Garmon, Federal Trade Commission.

MR. MACAVOY: Chris Macavoy from Howrey Simon.

MR. SCHER: Irv Scher, Weil, Gotshal & Manges.

MR. WARREN-BOULTON: Rick Warren-Boulton, MICRA Washington, D.C. I gather there's nobody here who isn't from Washington, D.C.

MR. SILBERMAN: Alan Silberman, Sonnenshein, Nath & Rosenthal, Chicago.

MR. SKITOL: Bob Skitol, Drinker, Biddle & Reath, Washington.

MR. STEUER: Richard Steuer from Kaye Scholer in New York.

MR. SAVRIN: Daniel Savrin from Bingham Dana in Boston.

MR. AVERITT: Neil Averitt from the FTC.

MR. SCHMIDT: Jeff Schmidt, Pillsbury Madison & Sutro.

MR. SULLIVAN: Mary Sullivan. I'm an economist at the U.S. Department of Justice, antitrust division.

MR. GUNDLACH: Greg Gundlach at the University of Notre Dame.

MS. DESANTI: Susan DeSanti, Federal Trade Commission.

MR. BALTO: David Balto, Federal Trade Commission. Since Dick Steuer hasn't been here before, I will tell him that the way you're recognized in this forum is by lifting up your name card and putting it vertically.

We're going to look at four categories of issues today. The first is the issue of market structure, buyer power and merger enforcement. The second is what's a good slotting enforcement action. The third is what kind of enforcement action should we consider in the category management area. And finally, what if anything should the FTC do in terms of guidelines and future studies?

To sort of pose the market structure buyer power issue, I've asked Dan Savrin to go and present some ideas that he's developed at much greater length in a paper in the Boston College Law Review. Dan.

MR. SAVRIN: Thank you David. I guess David wanted to make sure everyone was kept on their toes, because he's asked me to start off by talking about something arising out of a Finnish supermarket merger.

But the European union has looked at issues in a much more concentrated market than we have, and has identified a number of concerns that it has with regard to market structure and retail power. The question that I pose, at least posed as part of the beginning of this session, is whether U.S. antitrust laws, as both interpreted and enforced, ought to address issues of retail buyer power and the gatekeeper roles of large retailers in the overall retail marketplace. For today's purposes we'll focus on grocery, obviously.

The issue was, What is a gatekeeper? In looking at the market in Finland, the European Union identified the gatekeepers as large retailers who essentially performed a gatekeeper function by having dominance over both the procurement and the consumer marketplace.

And in that capacity they identified the retailers as really having the ability to exercise market power to determine who among the producers have access to the retail marketplace, the terms in which they have access, and basically leverage over those suppliers. At the same time the consumer wasn't necessarily a beneficiary of that retailer power, which is generally a primary assumption in our antitrust analysis of buyer power in the United States.

They also looked at the issue of increasing consolidation and increasing private label issuance. The powerful retailers not only exercise the ability to control and constrain supply in the consumer marketplace, but were essentially both a buyer and a competitor of their suppliers.

So with that all said, the question is: Do those issues apply to the U.S. marketplace? And there are a number of changing dynamics in the U.S. marketplace which bring that issue to the fore, most of which have already been discussed here today.

Among those issues are the increasing consolidation in the U.S. marketplace. When I wrote or sat down to start writing the paper which David mentioned, about four years ago, the top four competitors in the U.S. supermarket marketplace had about 25 percent of the overall market. Today according to Supermarket News that number stands at about 42 percent of the market retained by four firms.

In that time period, Wal-Mart was denoted as the third largest grocer in the United States. Today Wal-Mart is denoted as the second largest grocer in the United States, some 1/10th of 1 percent behind Kroger. The question then arises as to whether we need to look at buyer power and market consolidation issues and figure out whether the retailers both in grocery and elsewhere are functioning as gatekeepers in the U.S. marketplace and controlling both the procurement marketplace and the consumer marketplace. Is that an issue that needs to be of concern, today or for the future?

MR. BALTO: Let me first ask, what did the EC characterize as a gatekeeper? What are the characteristics that they look to to say that these firms would serve in this gatekeeper role?

MR. SAVRIN: Well, they looked at the overall market and the general market share, and made determinations by looking at the actual supply chain to figure out whether individual suppliers had appropriate alternatives available to them other than the potentially merged entity. I should note in that scenario the merged entity had like 55 percent of the overall Finnish market.

MS. DESANTI: So is that analogous to the exclusive-dealing type of analysis -- the sense of focusing on market share? Or what other questions beyond that were asked?

MR. SAVRIN: Well, they focused on market share. They also focused on exclusive dealing, but they looked quite closely at whether the supplier had an alternative outlet and looked at whether, if they allowed the merger to go forward, there would be no alternatives for suppliers other than that market. If that company, the potentially merged company, was the only source for purchasing or the primary source of purchasing they determined they essentially had power over the procurement marketplace.

MS. DESANTI: Could you explain, was the harm articulated in terms of harm to the ultimate consumer in the marketplace or harm to the supplier?

MR. SAVRIN: In the European Union analysis they looked at it in both contexts. I in my comments focus much more on the consumers, since that's much more of the U.S. orientation.

MR. BALTO: Of course we looked at a similar concept in terms of the significance of a single retail chain and its ability to exercise power on the buy side in the Toys R' Us litigation. In the Toys R' Us litigation there were some critical factors that suggested that it was relatively essential to the large manufacturers to be able to sell a number of their toys through Toys R' Us. And Toys R' Us was a much more significant distributor because it was much larger than the other chains.

Rick?

MR. WARREN-BOULTON: I guess to an economist it seems to me that in a sense it's misfocused, if indeed you accept the proposition that the fundamental thing of concern is attempts by dominant manufacturers to use control over downstream stages to exclude rivals, whether you think of that as the Microsoft case or others.

The critical issue is whether or not those gatekeepers are the only way to reach a particular group of customers. It doesn't really matter how many customers there are. In other words, the idea that the share that that small group of gatekeepers would account for is large, is irrelevant. You can enter into exclusionary contracts with hundreds and hundreds and hundreds of tiny little gate keepers. Certainly OEMs qualify in that characterization.

So the necessary condition for these kind of contracts to be used exclusionarily is not that those downstream firms have a large share of the market. It is simply that they happen to be the only way to reach a particular group or group of customers. But they don't have to have a large share.

And this is not something to be confused with other monopsony power or monopoly power on the part of the retail level. If you used those guidelines in Microsoft and asked, "Are the OEMs gatekeepers," there would have been no OEMs that are that size, and you would have thrown out the Microsoft case.

So it's not the share of any individual or the concentration of the retailers. Simply the question is, Can you enter into a contract with a large enough group of them so that you can foreclose rivals from access to customers?

MR. SAVRIN: If I just can respond quickly, I think in the retail marketplace, as opposed to the manufacturing and maybe the software marketplace, you would have to have critical mass either within a region or nationally in order to be able to essentially perform a gatekeeper function.

I think that differs from other markets.

MR. BALTO: Is there a suggestion by anyone that we have the potential for gatekeeper problem here in the supermarket industry. Bob Skitol?

MR. SKITOL: I think the gatekeeper power in and of itself is not necessarily bad or anti-competitive or something that causes a slotting allowance to be anti-competitive. I think buyer power is important -- is a necessary but not sufficient condition to slotting allowances being used in a way that is anti-competitive at the retailer level.

And I think market power at both levels, at the retailer level, and at the manufacturer level, are probably necessary but not sufficient conditions to slotting allowances creating an anti-competitive effect or exclusionary effect at the supplier level.

MR. BALTO: Let's hold that thought for when we get to what would make a good slotting allowance enforcement action. Let's just stick with merger enforcement. Based on the panel just before lunch, does anybody think that the FTC needs to ramp up its efforts at looking at the buyer power issue in supermarket merger enforcement, and if so, why? Yes, Chris?

MR. MACAVOY: Just to respond to that. I think it is an issue that is already being looked at, is my experience having been in investigational hearings and supermarket mergers. This is not a brand new question, but it is something that is being asked about the monopsony issue.

One thing, and I think you alluded to it this morning, that perhaps gets attention is that sometimes the efficiency claims that are brought in sound like they're premised on buyer power. Somebody might come in and say, We're going to leverage our size and to lower prices and go on to explain why that's good for consumers.

Well, that kind of presentation naturally leads to some questions about, Gee, is there a monopsony issue here? In my view those things are like unicorns. It's not really out there, but the questions are pertinent questions, and they are being asked. I think they should be asked.

MR. BALTO: Ron Bloch?

MR. BLOCH: I think that there is a very, very distinct need for power buyer policy and merger policy beyond that. If you look at the half dozen firms that today account for somewhere between 40 and 50 percent, which by the way is a level of concentration at the national level that this country has never seen before in the grocery industry, with the exception of one of those top firms, there's only one of them that got there through its own internal expansion.

The rest of them got where they are today through a series of very large mergers and acquisitions. Basically the Commission's traditional approach, which I don't say is the wrong approach, but looking at the seller side, focuses on overlaps of stores in particular geographic markets. To get a deal done you have to sell off enough of those stores to eliminate the anti-competitive effects in those markets.

But the buyer effects, the effect that it has on creating the kind of retail organizations that we have heard for the last day and a half to varying degrees do have the ability and in practice exercise their power by obtaining preferences of one kind or another, whether it's slotting, whether it's promotional allowances, whether it's special prices, special packaging. That doesn't seem to filter into the merger analysis, the buying side of the equation. I really think that this is something that should play a larger role in merger analysis.

And there's an anomaly here. We sit here for two days talking about the exercise of buyer power, and when there is a merger that takes place, the Commission has a policy. It's not a rule, but it's just an internal policy that requires, to the extent possible, that all the stores in a given geographic market be divested to a single firm.

In a market where there are a significant number of stores to be divested, that policy favors inherently strengthening the power buyers that we've been talking about. I think that's kind of an anomalous result. Again it requires some sort of harmonization of the policy toward power buyers and the way the merger process functions.

MR. BALTO: Alan Silberman?

MR. SILBERMAN: The question it seems to me, is not whether you should consider buyer power in a merger. It's how you look at it. Do you look at it over some period of time, projecting into the future, recognizing as we've heard for the last day and a half that there's an incredible velocity of change in the distribution system and that the snapshot you take today may not really be very accurate?

Do you look at without imposing one model or bias and say, This is the way competition is supposed to take place, or all preferences are necessarily bad. The problem we have here is that while we don't like it, competition is not neat. Competition doesn't work out to be everything in nice orderly rows.

It's more like Dupont Circle was before they built the underpass under it. Ultimately I think what you will come to after you consider all this is a recognition that what you're really talking about is not structure but behavior, and that you have other legal avenues for dealing with behavior, and therefore really when you get all done, it doesn't have a major effect on your merger analysis.

MR. BALTO: Dick Steuer?

MR. STEUER: I think in a real sense the gatekeeper function is being factored into merger analysis, in terms of looking for local monopoly power or at least market power, so that again it goes back to the notion of the strength of consumer preference, consumer loyalty to a particular seller.

If there are supermarket chains that are merging, giving them strength over particular markets where they have an enormous market share and there's a strong consumer preference for shopping in that kind of an outlet, then they very well may have the kind of power that you can be concerned about. But I think that's part of the traditional analysis already in looking market by market, which is normally what's done in acquisitions of this kind, and also what was done in Staples.

MR. BALTO: Mark Gidley.

MR. GIDLEY: Very briefly. First I will echo what Ron said, that I think in divestitures you want to look long and hard at some of the smaller chains buying stores. It can be an excellent chance for them to pick up some stores at 10 cents on the dollar.

The second observation I would make is that you mentioned that there are four firms, and one has gotten there by organic growth. It is going to continue to put enormous pressure on this industry. The consolidation wave is not something that is just the design of investment bankers. The consolidation wave is response to a 1,400 to 1,600 basis point gap in sales, SG&A gap that is owing not only to unions but also to the number of SKUs that the supermarket industry carries.

In terms of the gatekeeper function, if you were to do 10-K studies, I think you would find that mom and pop, ethnic, health-food stores are often the incubator for the pure startup. That was true of Nantucket Nectars. It's also true of, for instance, Snapple. Snapple then becomes extremely well distributed when they break into supermarkets. They can break in at five or ten stores. Soon they take over the full chain of the supermarket.

There's actually some free riding going on in terms of the gatekeeper function, because once the supermarkets assist Snapple in becoming a well recognized national brand, someone like Costco can free ride on the development and promotion of Snapple and skim the best SKUs.

Is that right? Is it wrong? Is it moral? Is it immoral? It's just competition, but merger enforcement I think already does but must continue to take into account this enormous gap. If it's the contention of the FTC staff that my client or some of the other supermarket chains are buying at exactly the same price as Wal-Mart and getting all of the benefits as Wal-Mart and getting all the category management support for free that Wal-Mart gets, you know, that would be very surprising to me.

MS. DESANTI: I think it would be useful -- I would like to just ask Dan to expand a little bit more on the point of when buying power can end up harming consumers in the marketplace. It's something you said you focused on in your article. The monopsony issue is something that's gotten less attention in antitrust. One of the things that is difficult about it is sometimes buying power can in fact reduce prices to consumers, so the question then becomes what's the line over which it needs to go in order to result in consumer harm. We'll start with Dan and then others may have observations on that as well.

MR. SAVRIN: I think you have to look at the marketplace. In grocery today, I think Mark makes two good points in terms of the other parties that are out there -- the clubs and the Wal-Mart enterprise. You need to take those into account in order to determine whether there really is a gatekeeper role, and whether there is a reduction in price, an ultimate reduction in price to the consumer overall.

When you get to other markets, and grocery I think may be heading that way with consolidation, you can look at other marketplaces where there is greater concentration, where you do have an operation like Toys 'R Us which is the place where companies have to be. We generally assume that if a company has buyer power, it can in fact reduce the price take it pays and will tender that reduced price over to the consumer.

If you get somebody who is in a gatekeeper role, the question is, Do they really need to do that and do they do that? Because it seems that if they've got control, significant control over the procurement market and they're the place for the consumer to get the products, the question is, Do they need to do that functionally?

And if they do, then we know that the consumer is benefitting. But they may not have to do that, and they may not do that, and in the Toys R' decision there were some allusions to whether or not that was the case. The question is in that scenario or other scenarios that are similar, does the consumer benefit from it or does the retail merchant just benefit from the gatekeeper power, and not need to pass on any of those benefits to the consumer?

MS. DESANTI: Rick?

MR. WARREN-BOULTON: Yeah, I think, following on, that we have two concepts that are very, very different. We have a concept of buyer power and a concept of monopsony. The reason why people confuse them is that both buyer power and monopsony lead to lower prices to the supermarket, but that's where the resemblance ends, because you have a different quantity effect.

In buyer power, what happens is they negotiate a lower price and they buy more. The monopsony, they buy less, and that's why they get a lower price. So if you wish to distinguish between buyer power, which is good for consumers, and monopsony which is bad for consumers, what you need to ask is the question, When you have had mergers -- and certainly the FTC can answer this question -- if you look at mergers and you say, We identified those areas where we were concerned or were potential candidates for buyer power and monopsony, look at what happened after the merger.

For that group of products, did the prices of those products relative to other prices of supermarkets rise or fall? Did the output or sales of those products rise or fall? If the prices of those products fell relative to other products and the output of those products rose relative to other products, what you've got is buyer power.

If the prices rose relative to other products and the output fell relative to other products, what you've got is monopsony power. Rather than worry about which head of the pin you're on, it seems to me that's a question, that now you have had enough experience with supermarket markets, that you can actually answer quantitatively. It's not that hard to do.

MR. BALTO: Ron Bloch.

MR. BLOCH: Rick took the words right out of my mouth. It seems to me that what you really need to look at is what happens to prices after the merger, compare them to prices before the merger, and see whether any of that lower acquisition price is passed on to the consumer, or does it drop to the bottom line for the benefit of the investors.

And you're not going to learn that in a workshop. You've got to send out some subpoenas. I think that's what's really is missing from the equation here.

MR. BALTO: Let me go on to the next topic. We would like the panel to tell us what would be a good slotting enforcement action. In doing so we would like to get a picture for us and the audience about what kinds of slotting activity we should be most concerned about. Can we also make an effort to describe types of slotting activity that we really shouldn't be concerned about at all, that might even fall into a per se legal category.

So let me open it up generally. What are the factors the FTC should look at for finding a good slotting allowance case. Greg?

MR. GUNDLACH: Well, I'll speak mainly to the analytical framework that I think has come to the table over the last couple of days. I think that provides you with a basis for understanding what a good slotting case is. If we're attempting to understand what slotting fees are and what their effects are, I think the first thing we need to do is come to terms about what we care about.

Over the last two days there's been considerable discussion of different criteria that we care about, things like efficiencies, things like price, things like process of rivalry, things like innovation, choice, fairness. I'm not sure all of those criteria are complementary, so I think we need to wrestle with what we are interested in.

And having decided that, I think the next challenge for us is to attempt, for any particular case, to organize the facts in a way that reveal the issues. As we've seen over the last two days, there have been some things that allow us to do that.

I think the first thing we might be looking at, maybe not necessarily in this order but an important factor is, Who's motivating the arrangement? The last two days we've talked about upstream effects, and we talked about downstream effects. The type of exclusivity on the part of the manufacturer being a downstream effect, and we've also talked about an upstream effect as it relates to retailers and monopsony power and their ability to leverage their place in the marketplace and obtain these fees from manufacturers.

I think in addition to that factor we need to consider the dominant factor. Are we dealing with dominant firms either at the manufacture or the retail level, and how does that mix? The presence of dominance obviously creates tension for the process of competition.

I think in addition to that, a third factor is what type of fee do we need to understand? What type of fee are we dealing with? We've talked about the issues that are confronted when we deal with a fixed fee, an up-front fee as something that's differentiated from a fee that's tied to volume or a fee that's spread over a period of time.

In addition, what has emerged over the last two days is another factor, and that is whether or not we're dealing with a new or an established product. The pay to stay fee is one for an established product, and we should be aware of the differences that are there, particularly as they relate to efficiencies when we distinguish between a new product type of scenario and a fee for an established product.

I think beyond that, one of the things that's revealed to me is we don't know much about the structure or process of the arrangement. In terms of where we go from here, understanding exactly what happens when that fee is paid, where it goes, how it's accounted for and what types of efficiency outcomes are achieved are things that we need to get inside that black box and begin to understand.

Finally, then, other practices. We talked about category management. I imagine there's a lot of other things that blend into the negotiation between the manufacturers and the retailers. I think that's an important thing to put on the table.

MR. BALTO: Well, from this side of the table you can see that nobody is interested in responding. Why don't I start off with Alan Silberman, and why don't we try to focus on the taxonomy that Greg has prepared for us.

MR. SILBERMAN: Taxonomy. That sounds like a barrier to entry. I'm going to steal Rich's thunder because I think he said it this morning, and he said it correctly, that the fundamental issue is the situation where dominant manufacturers engage in conduct that is an attempt to do something that's almost a bribe to raise rival's costs. I don't know that I would call that slotting allowances, but that seems to me to be the focus.

I would add to that, possibly more broadly echoing Steve Salop, that manufacturer-initiated strategies on exclusive dealing are worth some look at, and possibly also the question of action by retailers which has the effect of denying information to other manufacturers. That comes out of the category captain area.

What I would exclude from enforcement activity for all sorts of reason are the things that are the more classic slotting allowances -- the one time payment demanded by retailers for access, other sorts of things like that, the bidding situations. That's the way I would cut it.

MR. BALTO: Can you elaborate on those last two? What's the one time fee and what's the bidding?

MR. SILBERMAN: Well, the classic slotting allowance that I think we really are talking about is the situation where you have new product access, and there's an up-front payment for access for the new product. I know that there are smaller people that said, Gee, I can't afford it, but as long as there's a competitive market functioning, that is not going to be problematic in terms of the big picture. Sure, it's going to affect various individuals, but it's not an area where I would place a great deal or, for that matter, any enforcement action.

The bidding situation is what you kept trying to push people to -- or whoever, I'm not sure if it was you. But it was a question of pay to stay, that is, are there situations where a retailer has said -- and this can be any retailer large or small -- The time has come to take a look at this set and say, I would like to get new proposals simultaneously.

That bidding process is going to result in price changes. It's going to result in all sorts of things. I would not be concerned about that. It sounds to me to be exactly what competition is all about. I would worry about the other things.

MR. BALTO: If professor Salop was here he might disagree.

MR. SILBERMAN: I think he would.

MS. DESANTI: Alan, can I ask you one follow up question? Is it possible for a slotting allowance to be used as a strategy by a dominant manufacturer as an attempt to raise rival's costs, and what are those situations?

MR. SILBERMAN: I don't think so, for two reasons. One, I would use the phrase slotting allowance only where it's demanded by the retailer, and therefore I would distinguish from the manufacturer-initiated situation. So, no, it wouldn't be that kind of a situation.

Number 2, I look at the slotting allowance, or more precisely the new product introduction cost item, as being a one-time short-term event. Therefore, it's a lousy strategy to raise rival's costs. If someone really wanted to do that, they would do something else.

MR. BALTO: What if it wasn't requested by the retailer? What if you had evidence it was a manufacturer inspired strategy?

MR. SILBERMAN: Then I think it moves to a different category. One of the premises, certainly developed in all the long written stuff that I have, is that we ought to stop talking about the word slotting allowance, and we ought to be more precise and talk about different categories.

Where you are dealing with manufacturer

initiated conduct, I will pay you. I haven't heard of anybody who offers to pay not in return for something, so there must be something that's coming back. Okay, now what is it? Is it exclusivity? Is it creating some barrier to a designated competitor? There's some reason.

Those are things that now call for further analysis. They still may not be improper, but they move away from the first category.

MR. BALTO: Irv?

MR. SCHER: Well, I just want to add a little to what Alan said, because I agreed with everything, and the last part. An auction for scarce shelf space hardly violates the antitrust laws, and there's a meeting competition defense built into the Robinson-Patman Act, so that certainly is not a practice that the Commission should challenge.

In addition, I cannot fathom a secondary line antitrust case coming out of a situation like McCormick, which I am an outsider to and just read. The lesson I took away from that case for my clients is if you're going to drive your competitors out of business, and can stay above cost when you do it, then do it quicker by giving the lower price to everybody rather than discriminating against some.

MR. BALTO: Rick?

MR. WARREN-BOULTON: This is just perfect. I'm seeing attorneys with whom I'm in agreement. I would only add one more condition to this. I think, based at least on this end, that what we would do is just safe-harbor any new product. In other words, we're only talking about established products, and then what are the hoops that you would have to run through at the very least?

The first is that it's really not a slotting allowance. It's an ongoing payment. It's not a one time matter, so first it has to be something that's initiated by the manufacturer. This is something that's being initiated by the retailer. This is not something of concern.

Secondly, it has to be initiated by what we would call a manufacturer with monopoly power, the ability to raise prices and exclude rivals. This is how they exclude rivals.

And third, the exclusion has to make sense. In order for exclusion to make sense, a necessary condition has to be that when you look at the downstream firms, if you like bidding on an all or nothing basis, it's difficult or impossible for the small firms.

It's got to be the case that the small firm --

the rival -- would find itself at a competitive disadvantage if they had to bid for the whole rather than a part of it. That was true of Microsoft. That's a very small number of cases. You narrow yourself down to a set of cases where you can, in fact, argue that there really is a potential competitive harm. If you satisfy all those criterion, you bounce back and say, Well, is there an efficiency defense on the other side.

But I think to run through at least those three hoops -- initiated by the manufacturer, manufacturer with monopoly power, and that the characteristic of the downstream firm is that the rival cannot compete on an all or nothing basis as opposed to for a part of their business -- those are three necessary conditions, not sufficient but necessary conditions for there to be harm.

MR. BALTO: I want to try to get joinder on Rick's three points. Is there anyone who disagrees with Rick's three points?

MR. SKITOL: I think everything so far is ignoring the Robinson-Patman Act. Discrimination is a factor that is relevant.

MR. BALTO: Let's set that aside. We want the scenario for a Sherman Act case. Is there anybody --

MR. MACAVOY: David, let me just add one thing.

I agree completely with the comments that have been made that a bidding context ought to be outside of our area of concern. But on the question of, Well, a distinction ought to be made between new and existing products, you just need to be careful about how you're defining new.

The comment was made a couple of times today that, Hey, watermelons have been around forever. True. Branded produce has not been around forever. There's a reason why you're seeing a lot of the tension and friction coming out of the produce sector.

It is because that is now becoming a branded sector with all these prepackaged products, the wonderful salads, et cetera, so we need to be careful. I'm not sure we can develop a workable definition of new product.

MS. DESANTI: Bob, let me ask you, just looking at it as a Sherman Act issue, and leaving aside the for the moment the Robinson-Patman Act, do you agree with the criteria that have been set out here, and if not why?

MR. SKITOL: Not entirely. If we can broaden the scope, though, to not just the Sherman Act but to Section 5 of the FTC Act questions, I think there are other circumstances beyond Rick's criteria where slotting allowances can cause accumulative anti-competitive effects upstream and potentially downstream also, and that ought to have legal ramifications.

You could have a situation where a manufacturer gladly pays an excessive slotting fee for a new product entry without an explicit exclusivity quid pro quo, but with an exclusionary effect, and it has an exclusionary effect because the amount is excessive. If the fee was a fee that bore some reasonable relationship to new product introduction costs, I would say safe harbor, close the books, don't even look at it.

But if it's a situation where the amount of the fee, and we've heard lots of examples in the last day and a half where this is the case, if the amount of the fee is way beyond any conceivable cost justification, then the efficiency story doesn't apply. We don't have to worry that we are interfering with an efficient practice, and the payment is likely to be entry-barrier-raising vis-a-vis smaller rivals. Then the situation is worth a close look as to whether there is at least, if not an explicit exclusivity quid pro quo, then at least something implicit or an exclusionary anti-competitive effect from it that warrants enforcement concern.

MR. DESANTI: Am I right in taking from what you're saying that what would signal to you, as a potential problem, is the size of the fee as meaning effectively that exclusivity would result? This rather than an enforcement action directed at, There is too high a fee, because in general antitrust doesn't get to say, Well, those are high prices, we don't like them, I think we'll attack them now?

MR. SKITOL: No, no, but this is a context of market power being exercised at both levels in a mutually reinforcing manner. It's an artificial one-time payment. That's another differentiator I would draw. I think it's important to distinguish between the flat one-time payment unrelated to volume versus a slotting fee that is in the form of a per unit discount.

I would basically exempt or immunize the per unit discount from any serious scrutiny. The difference between the two is it's the huge excessive one time flat payment unrelated to volume that causes the real problem for smaller manufacturers, versus the per unit discount which even small manufacturers ought to be able to afford over time.

And secondly, the per unit discount is much more likely to end up translating in to a downstream lower price to the consumer. So there is the potential offsetting good from the consumer standpoint versus the flat payment unrelated to volume is much more likely to go into the retailer's bottom line.

MR. BALTO: Okay. Is there anybody else who disagrees with the three set of points that Rick Warren-Boulton made? Neil?

MR. AVERITT: I don't exactly disagree with them, but it does seem to me that the real world may be in some respects a little more intractable and a little more ambiguous than some of the tests that were suggested seem to count on it being.

It would seem to me, first of all, that it may be hard to draw a distinction between up front payments and payments over time, at least for certain product lines where a manufacturer's product line may change from year to year as new products are introduced and old ones are phased out. So the distinction between pay to stay and up front may begin to get a little blurry.

It may also get to be a little blurry whether a particular payment is actually instigated by the manufacturer or the retailer. There's probably a certain amount of tacit bargaining that goes on there, and how that affects the ultimate answer, I don't know, but it may affect the ease of applying certain tests.

MR. BALTO: Mary Sullivan, are you going to agree with Rick?

MS. SULLIVAN: First I'm going to say that there's always ambiguity in these issues, and that's why you usually have to hire economists to help you think about them.

MR. WARREN-BOULTON: My kind of gal.

MS. SULLIVAN: I don't really want to challenge the criteria, but I do have a question that Rick might be able to help me with. It seems that the theory that you're using to evaluate whether these fees are anti-competitive are the basic raising rival's cost theory, or that is a theory. That's the one I was thinking about.

And I know, according to this theory and maybe other theories, that retailers can certainly benefit from the fees as well as manufacturers. So if a retailer can look at a situation and say, Hey, maybe I could get this one manufacturer to pay me a fee and it could exclude this other one and I would be better off, then why wouldn't a retailer in that situation initiate a fee?

MR. WARREN-BOULTON: I guess a couple of things. One, I think there is a raising rival's cost, and there's a variant of Steve's thing which is reducing rival's revenues, is you're willing to pay less for the rivals. Are you referring to the idea that retailers as a group like slotting fees, but they're higher in marginal price to everybody, and so they're more likely-- a form of implicit exclusion among retailers which is not --

MS. SULLIVAN: I wasn't really thinking of that. I was just thinking that with an exclusion theory you can have a manufacturer who can pay these fees to exclude a rival, but sometimes in order to do that, the manufacturer would have to cut the retailer in on the deal, making the retailer better off.

Now, if the retailer can anticipate that then why couldn't the retailer have the idea just as easily as the manufacturer and initiate the fee first?

MR. WARREN-BOULTON: The gain here is monopolizing people other than the retailer. The gain comes from the third parties. That's essentially where you're getting. You have an implicit agreement, I think, in most of these models between a manufacturer and a retailer that says, Okay, retailer, you will do something that doesn't appear to be in your best interest. You will sort of help me exclude a competitor, and I will pay you off for doing that.

MS. SULLIVAN: Right.

MR. WARREN-BOULTON: And the reason I can do that is there are third parties out there that are going to be facing higher prices who are not being paid off. The point is that if I can get a critical mass of retailers to go along, if I can get enough OEMs to go along with me so I can freeze out an operating manufacturer, to randomly think about this.

The point is that's in the interest of every single one of those OEMs to accept that bribe even though they may see as a group they will probably be a little bit, not much, a little bit worse off if they all accept it, but it's not too hard to get people to sort of go along with this when in fact they are not united.

That's the odd thing about the EU proposal we started with. If a retailer had 100 percent of the market, he wouldn't agree. It's in fact critical that he has a small enough share that he says to himself, It makes sense for me to sign on, even though the system-wide effects of this from the point of all retailers is bad.

So it's a combination of having a manufacturer with market power and a retailer who doesn't have market power but is a gatekeeper that I think is the critical element here. I don't know if that's --

MR. BALTO: Rick, that's it.

MS. SULLIVAN: Sure.

MR. BALTO: That's an interesting structure, but something I don't see here is, What's the evidence of anti-competitive effect that's necessary? Ultimately I have to go to my bosses and say, We should do this, and they're going to say Why, how are consumers affected? So what should we look for as evidence of anti-competitive effect?

MR. WARREN-BOULTON: I think that the answer is that you have rival manufacturers who are able to compete on a level playing field. They go to the retailer, and they say, I'm willing to supply a product at the same price, equivalent quality, and if the retailer says, Nope, I'm not willing to do that because if I start buying some of my requirements from you, either my costs aren't going to change as was the case with CP licenses, or there's going to be some retaliation from the dominant manufacturer. I have some contract here under which what I have to pay the dominant manufacturer goes up when I start dealing with you.

I would handle it in the way we handle all these exclusion cases, and by now we've accumulated quite a set of them, so we really know what they look like. It becomes possible to deal with this, not just deductively like economists, but inductively. We have a large enough set so we can look at the common characteristics.

MR. BALTO: Does everybody agree with Rick's observations on the evidence of competitive effect? Dick?

MR. STEUER: There seems to be something of an inconsistency between that last point and the point made earlier, that all quantity discounts are always lawful. I think this goes, David, to the article you recently coauthored, that in some instances some types of graduated discount schedules can result in exclusion, depending on market shares and depending on the power of the product itself. This is the subject of quite a bit of litigation right now.

I guess one point I wanted to make, that I think is being lost a little bit in terms of how to structure an investigation, is to look at exactly what is being paid for. It seems we've talked about three things that could be paid for. One is favorable placement. One is entry, and the other is exclusion.

In terms of favorable placement, there are two ways to sell products in this world. There's push and there's pull. What retailers have to sell is pull, and what manufacturers can buy elsewhere is push. I think it's important to recognize what exactly is being paid for, what other ways are there to sell products.

And kind of a neat way of looking at this is in terms of placement. Just think about, not somebody who's got a limitation of physical space, but Internet sites that are also functioning as retailers, and also in effect take slotting allowances to give favorable positioning, except they have infinite space, and it's an interesting contrast with what happens in the physical world.

MR. BALTO: Since you mentioned placement, Irv Scher is involved in some really interesting litigation involving tobacco companies. Part of what we asked the earlier panels about was, Are slotting allowances or promotional payments ever paid to provide for advantageous or place rivals in disadvantageous shelf space? I think Irv has something to contribute on this subject.

MR. SCHER: Well, let me say that I'm of course biased. I represent one of the plaintiffs in that case in the tobacco industry. Let me just tell you what the claims are.

The claims are that a dominant manufacturer with more than a 50 percent marker share, and a 35 percent brand, where the next brand has about 8 percent, is using that kind of dominance to essentially exclude competitors. There's no claim of below cost pricing, claims of in the Godfather sense an offer that couldn't be refused by the customers.

Most competition in this industry now has gone to the pack market, because cartons are so expensive that the only place where there's a brand versus brand to get brand switches is in the pack outlets. The pack outlets are basically not the supermarkets. It's the convenience stores and the gasoline dealers.

I'm going to go back to the plan as it was originally adopted because it's been modified a few times, as it was challenged. The plan offered what they call in that industry "buy downs" which are promotional pass-through funds -- I'll give you 50 cents a pack and you pass it through to the consumer.

There's tremendous price competition in this particular market at the retail level. You've got mobile consumers. You've got very heavy in-store advertising. There's very little other advertising that's permitted any more in that industry, so it is a special category.

The Phillip Morris plan said to the retailers, If you give me my space to share -- which is noted in the article that you and your colleagues wrote -- then I will give you the better buy downs. I have very low buy downs. I have higher buy downs.

You really want the higher buy downs to be competitive with the other retailer, so it becomes something you really need. Therefore if you give me my space-to-share, which sounds logical, I'll give it you to. However, there were some add-ons.

One add-on was that the space had to be the 50 percent -- which is their market share -- of the visible space. If you've ever been in a convenience store or a gas station you know that the cigarettes are behind the counter. That's being caused by regulation, fear of theft, various factors.

So they said, We want 50 percent of the visible space. And we want all of the products, to get this money, to be laid out horizontally, not vertically. So therefore when you walk in to a convenience store, what you see is a sea of Marlboro country, a sea of red because everything else is in the lower half below the counter. That was one of the claims.

Another claim was that although the competitors could do what they want with their open space, there were some limitations. What they couldn't do is have a sign up for a promotion, for example, for more than 28 days.

If you're going to have a promotion, Mr. Competitor, you have to take that sign down and do something else. It's unclear whether it's another brand, another company, after the 28 days. In addition, three weeks out of every quarter, Mr. Retailer, you cannot price-promote any other product.

So those things go a little beyond space for share, and there are other things, but the basic claim is that they are exclusionary, creating market foreclosure. The other guys, the other three are fighting to pay more for worse space, and that's raising rival's costs and then some.

MR. SILBERMAN: Good case. The last part is a good case.

MR. BALTO: What do you mean, Alan? You said the last part is a good case. You mean those last two non ancillary --

MR. SILBERMAN: As he got to the add-ons I got really interested. I mean, the first part of the description almost sounds not too much different than saying either space allocation is driven by IRA data or Nielson data. It's pretty neutral. You have 50 percent of the sales, you get 50 percent of the space. That doesn't trouble me very much.

Saying that I'm going to make available a promotion to you, and having gone to all the expense of promoting it, I don't want to be hidden -- that doesn't bother me. When we see it in a bigger context, I think he's got an interesting case.

MR. BALTO: Can you explain, Alan, those first two things that you said didn't bother you? Why didn't they bother you? Why should we as antitrust enforcers not be bothered?

MR. SILBERMAN: The decision by a retailer, even if it is induced not by payment but by persuasion and so on to say, This product placement will be most beneficial for you, here's the data that support it, that is a decision that a retailer is entitled to make, entitled to change from time to time if it doesn't work. You ought not care about that part of the decision at all.

The next part of it that is the -- what was the next part of it?

MR. BALTO: Telling you you couldn't advertise or --

MR. SILBERMAN: No, no, no. The next part of it was the promotional payment. I as a manufacturer have the perfect right to say to somebody that, I want my expenditure to be used in an effective way, and if you're not going to be effective or you're going to be less effective, I'm going to -- subject to the Robinson-Patman Act -- I'm going to moderate the promotional benefit that I'm giving you. That doesn't bother me.

What begins to bother me is the ancillary activities that very much sound like preventing my competitor -- not just doing a better job promoting, but preventing my competitor from coming up with something that will allow it to market its products.

MR. BALTO: Good. At this point I would like to turn back to Bob Skitol's idea that we should look at these problems under Section 5. Is there anybody who disagrees with the idea he posed, of slotting allowances causing problems in less concentrated markets if you look at it under Section 5 theory?

MR. GIDLEY: I have a problem with that. You know, I agreed with a lot of the discussion and stifled myself to the group's mutual benefit, but it seems to me that slotting allowances for new products really ought to be per se legal. There's real costs, that's conceded by all, and there are really opportunity costs that are extremely difficult to quantify.

So now the next topic could be, Let's regulate the form or the amount of the new product slotting allowance. Let me take that topic on. I think if the FTC were to engage in that, it would lose its soul. I think that you would have an infinite level of Rule of

Reason challenges to every new product introduction slotting allowance.

You can take anything and put it under a Rule of Reason microscope. If you wanted to you could say Costco's membership fees should be analyzed under the Rule of Reason. Does it cost them 35 bucks to take my picture? No, it cost them a quarter. Okay. So now there is what, $34.75 has been extracted from millions of people like the Gidleys.

What do I say? Oh, my goodness, I'm not letting my wife renew? I think it's been a wise rule to say, It's really not a good use of our enforcement resources to look at that, even if that seems facially high and that you have to go out as a family and buy by 5 or 600 bucks worth of stuff to enjoy the benefit of the great cost reductions that that great procompetitive merchant has.

That's the way it goes to market, and I don't think the antitrust laws as a per se matter say that's good, bad or ugly. I just think you can't inquire on that level or we wind up doing 35,000 Rule of Reason cases.

MR. BALTO: Bob?

MR. SKITOL: The Costco membership fee doesn't even begin to be a barrier to entry by smaller rivals.

A multimillion dollar slotting fee does, and that's the difference.

MR. GIDLEY: It's a barrier to entry to consumers.

MR. SKITOL: Well, I think Section 5 of the FTC Act should be concerned about serious artificial entry barriers being introduced into the equation without any efficiency justification.

MR. GIDLEY: And my very short answer to that would be that slotting allowance have existed for at least 30 years, which tends to indicate to me that it's a practice that goes back way before this retail merger wave, and that it's probably inherently procompetitive, and it supports great variety in these stores, and that would definitely be part of a rule of reason attack.

MR. BALTO: Alan?

MR. SILBERMAN: First of all I don't think Section 5 of the Federal Trade Commission Act stands for the proposition that when you have ambiguous behavior that you wouldn't address under the antitrust laws because the effects are not clear, that you should therefore say, Now I can use Section 5 to get in to the same subject.

The proposition that you have barriers to entry here, that have really affected overall competition in a relevant market as opposed to individual competitors, I don't think that proposition can be sustained empirically. If you had that proposition, you wouldn't need Section 5.

So I don't think Section 5 is the answer on either of those points. The only place I would put Section 5 in is for the people who complained about the situations where retailers took deductions from invoices.

There I think you can make a very interesting argument that it's an unfair act or practice in commerce, that the retailer knows that no individual supplier is able to challenge it, even though it probably violates the UCC. It's a contract breach, but nobody is going to be able to sue, and they're taking advantage of that, and there I would think maybe the Commission can use Section 5.

MR. BALTO: Rick?

MR. WARREN-BOULTON: I guess, to me, I look at this, and the criterion really are pretty clear. You have to have what I would call monopoly power at the manufacturer level, and by that I mean not just market power, not just a Herfindahl over 2000. I'm talking about unilateral ability of a dominant manufacturer to raise prices and exclude rivals, and that is an absolutely essential prerequisite.

If you don't use that as a screen, please, you'll make my day. What can I say? From an antitrust consultants point of view, that would be terrific, but it's the sort of thing that will make Bill Baxter roll over in his grave. It is an essential screen.

On the other hand, I don't think you need any screen in terms of market power for the retailer, but you really do need a monopoly power at the manufacturer's screen before you get any further.

That being said, of course it's a barrier to entry. Stigler would say it's a barrier to entry. Barrier to entry is something the entrant pays and the established firm didn't pay. Well, most of the established firms came along at a time when there weren't barriers to entry. There weren't slotting fees, so is this a cost that entrants are paying today that established firms didn't pay way back then? Yes. Are there rents to established firms as a result? Is there anything we should do about it? No.

MR. BALTO: Rick, if you had Irv's tobacco case but the manufacturer imposing it only had a 30 percent market share, but was effective at imposing those restraints, including the two restraints that Alan doesn't like, would you be concerned?

MR. WARREN-BOULTON: Well, remember the definition of monopoly power. It's the ability to raise prices and exclude rivals. You just said to me, Let's assume they can exclude rivals. I would say they've got monopoly power. I mean, his case fits the characteristics. It's not a new product, unfortunately. It's a very established product. It's initiated by the manufacturers.

It's at least a dominant manufacturer that appears to have the ability to exclude. The downstream firms are ones where the rivals want to have some space but not all. They can't go to the convenience store and say, Take me instead. Marlboro is essential, at least some Marlboro is essential for every convenience store.

And if you wanted to add another criterion, if you look at the payment, and it looks like it's a payment for exclusion -- if you want to add that as a fourth criterion, so it fits.

MR. BLOCH: I would like to ask Rick a question if I could, David.

MR. BALTO: Sure.

MR. BLOCH: When you said a minute ago, Rick, that you weren't worried about having a screen at the retail level, did that mean that you aren't concerned at all about a retailer's power in a market, or that you aren't looking for them to have monopoly power like you would at the manufacturer level?

MR. WARREN-BOULTON: Oh, no. I think the FTC is looking at supermarket mergers. Looking at monopoly concerns by supermarkets is I think perfectly legitimate and even classic monopsony power issue. But if the issue is slotting allowances, are we interested simply in the role of slotting allowances and how that affects the analysis?

Then I guess my answer is that the only way -- I think I mentioned this before -- the only way which mergers among supermarkets affect slotting allowances' ability to be used as exclusionary devices is if it makes the kind of multi-outlet agreement easier to negotiate. It's easier to negotiate with one big supermarket than with 20 little ones.

That's a transaction costs story, and it's their concern.

MR. BLOCH: I think I agree with you but for very different reasons.

MR. BALTO: Let me give Bob Skitol a chance to reply to that, and then I hear the voice of Congressman Patman in the background asking a question.

MR. SKITOL: I hear the voice of Brandeis in the background.

I don't think there's a major difference between Rick and me. It's just that I think Rick ought to be at least a little open to a scope for Section 5 that's at least a little broader than Section 2 of the Sherman Act.

There are situations, and I think the slotting fee phenomena generally in the grocery industry is such a situation, where there is a cumulative exclusionary impact at the supplier level as a result of multiple anti-competitive abuses of slotting fee practices on the part of numerous different firms, each of which has market power but not monopoly power.

I may be right or wrong factually, but just for the moment assume that there is a record showing that there is a general slotting fee problem in this industry, that there are lots of abusive uses of slotting fees. The problem is it's very difficult to attack the problem under the Sherman Act because there's no Phillip Morris. There's no one firm with clear monopoly power that's guilty of all the abuses.

Rather, in any given sector, in any given product category there may be three different firms. No, let's make it simpler. Let's say it's a product category with two dominant firms, each of which is making abusive uses of slotting fees to raise entry barriers against smaller rivals but neither of which has market power, so neither of which is reachable under Section 2 of the Sherman Act.

Yet each of them is engaging in conduct that contributes to an exclusionary effect on smaller rivals, and that cannot be justified on efficiency grounds. Why can't we use Section 5 of the FTC Act against both of those firms?

MR. WARREN-BOULTON: I agree with the economics. I can't answer why we should use Section 5. I plead not being an attorney as my defense.

MR. GIDLEY: It might not help you.

MR. WARREN-BOULTON: The scenario set up is one which certainly an economist would agree with. It's shared monopoly.

MR. BALTO: Just to change statue slightly. What about Robinson-Patman enforcement? Is the slotting allowance problem one that's more appropriate or as appropriate for Robinson-Patman enforcement, and what are the kinds of Robinson-Patman enforcement that are appropriate? Ron?

MR. BLOCH: I think the focus on slotting allowances is misplaced. We heard time and time again today and yesterday that if you push down slotting allowances, you're going to get something else popping up under another name.

The general agreement that I heard primarily today was on the need for a level playing field, and that is a statement that came from somebody purporting to represent manufacturers. It came from retailers, large and small. It came from the only wholesaler who was on the panel this morning.

If the need for the level playing field is as universally accepted as we heard today, it seems to me that you can't avoid the discrimination that exists in the marketplace because large customers are able to get a bigger slice of the total bucket of funds that manufacturers have available. Others get a disproportionately small share, and a third group gets nothing.

If you want to deal with the problem of competitive advantages and disadvantages in the marketplace, in the grocery industry, and do something to attempt to level the playing field, then Robinson-Patman has to be part of the equation.

There's no avoiding it unless you want to say, Well, then just bring Robinson-Patman cases under Section 5 of the FTC Act because nobody likes to mention the word "Robinson-Patman." I don't have any inhibitions about it whatsoever.

The bottom line is that if you are focused on slotting allowances, you are looking at one symptom, and you are ignoring the disease. If the disease is going to be attacked, then you have to look at the whole sphere of discrimination that exists today in the grocery industry, and I submit to you there's plenty of evidence to suggest that it is worse today than it was when the Federal Trade Commission wrote its report back in the late 20s that ultimately led to the passage of the Robinson-Patman Act in the first place.

MR. BALTO: Let me just ask one question, Ron. What if we concluded that the really most egregious aspect of slotting allowances was that it deterred entry, particularly for small manufacturers, and raised the cost of expansion? It seems to me that bringing Robinson-Patman Act cases against dominant manufacturers would just be basically telling them, When you go and you adopt a strategy to drive these small people out of the market, be sure to offer the same slotting allowances to everybody, big and large, and that wouldn't solve the problem at all. In fact it might make it worse.

MR. BLOCH: It probably would solve the problem because I don't think there's a manufacturer that has the money to abide by the stature.

MR. SKITOL: Yes, that's the point for them. It would make that form of predation a lot more expensive.

MR. BALTO: Alan?

MR. SILBERMAN: The Robinson-Patman Act, as you suggested earlier, is a simple statute, and everyone knows what it means, and of course it's got to be part of the equation because all laws have to be part of the equation. But there's some things I think we ought to recognize that it doesn't mean. It doesn't mean that there is always a level playing field or that everybody has a right to be on it, and it doesn't mean that there's some standard of fairness that gets superimposed just generically over behavior.

There is a level playing field in some sense, but what we are talking about here, by and large, are pricing situations in which we have tests of injury to competition. We have recognition of functional differences between firms. If we go to the suggestion that what we're really dealing with here are leases of shelf space, then we have to deal with the fact that the transaction is probably even outside the statute because the 7-Eleven is leasing one type of product whereas the large supermarket is offering for lease a different type of product.

You have meeting-competition in which the way the law has developed, I think correctly, is that a person can elect to meet competition in some but not all situations. That is not a level playing field. That can happen, does happen.

So, yes, the statute applies, but unless we're going to write half the statute out and simply say it's a level playing field, be fair, love one another statute, which may have been its intent but it's not its words, then it doesn't do a great deal to deal with this problem.

MR. BALTO: Chris MacAvoy?

MR. MACAVOY: I'll respond I guess both to Ron's point and to the theme that we did hear, and I heard this a lot in the last two days too, about people in various positions saying we want a level playing field.

I think everybody understands that can't be delivered. It can't be delivered by Robinson-Patman or by the FTC under Section 5. I mean, there is still this overarching problem that companies that have bigger budgets for advertising, that have more established reputations, that are out there doing product testing, they're going to be at a different places in that playing field.

That's just the way it is in a competitive system. So although you heard the rhetoric of, We want a level playing field, I think most people realize that it's not going to come out of this and shouldn't come out of this.

MR. BALTO: Irv?

MR. SCHER: I'm going to start by quoting from a great antitrust scholar. He said that the Robinson-Patman Act was the misshapen progeny of intolerable draftsmanship coupled with wholly mistaken economic theory.

The last time that the Federal Trade Commission actively enforced the Robinson-Patman Act was in the 1960s. I was there. I don't know how many others around the table were. I was there. Let me tell you, it retarded new forms of competition, this act of enforcement of the statute.

The Commission would not recognize efficiencies, to the great dismay of Phillip Elman, who was a great antitrust lawyer and Commissioner. It protected inefficient forms of distribution. It led to price rigidity and even price coordination. I was there when some 200 apparel manufacturers lined up to agree to a consent order so that they would be able to stop paying the advertising and promotional allowances that were being demanded by apparel retailers.

I think it would be a great mistake for the

Commission to do so, to start enforcing it actively again, particularly in this area, because, as has already been said by some, an up-front slotting payment not related to the sale of products, that goes into the corporate treasurer of the retailer, not only I believe is outside the scope of the Robinson-Patman Act, but the Supreme Court has told us it doesn't create antitrust injury in the Truett Payne case, so therefore there really can't be a private suit in that kind of situation.

And the last point I want to make is the Supreme Court's view of the Robinson-Patman Act. Again I'm going to quote from two Supreme Court decisions: "Interpretations of the Act should not extend beyond the prohibitions of the Act, and in so doing help give rise to a price uniformity and rigidity in open conflict with the purposes of other antitrust legislation.

That's from one of your cases, the A&P case, and from Gypsum, the Supreme Court stated the Robinson-Patman Act" should be construed so as to ensure its coherence with the broader antitrust policies that have been laid down by Congress.

MR. BALTO: Well, that was very articulate, Irv. You'll rest assured that I spend all of my free time going through old files looking at old cases that possibly we could resurrect and bring again.

MR. BLOCH: David, could I just respond to one point that Irv made?

MR. BALTO: Sure.

MR. BLOCH: That is that slotting allowances may be totally outside the scope of the Robinson-Patman Act. I find that kind of an interesting, if not contradictory statement, because in the McCormick case that we talked about earlier today, the Commission said that was price discrimination, and they came out with a 2(a) complaint.

MR. SCHER: Involving 2(d) and 2(e) practices.

MR. BLOCH: That's another whole day of discussion that I don't think is within the scope of the workshop, but I agree with you 100 percent. And in addition, they not only challenged the practices that were obviously under 2(d) by the language of the complaint, they didn't enter any 2(d) relief, but that's another story.

MR. BALTO: Let me go to one of the ultimate questions. If slotting allowances are a problem -- I am going to ask Rick this question -- what would the appropriate remedy be, if we find a violation?

MR. WARREN-BOULTON: Can I quickly comment on this?

MR. BALTO: You have one minute.

MR. WARREN-BOULTON: One minute. I'm not going to say anything about Robinson-Patman because it's a mystery to me. Where slotting allowances have come in, however, I think has been in situations where there have basically been auctions -- actions to be the only supplier of a particular product to a supermarket.

That's the only situation in which as far as I know slotting allowances have intersected with the Robinson Pattman Act. These are auctions. They're bidding markets. You know, it doesn't make sense to think of it in terms of -- By definition the prices are going to be different because it's a bidding market, so I find it incomprehensible why anybody would think that that doesn't do a meeting-competition defense.

And I think it's fundamentally unsound to bring, should we say a Robinson-Patman case alleging secondary line injury, when you're really worried about primary line injury. If you're worried about primary line injury, face it. I think that's really the answer to the second question, which is that you should treat slotting allowances as just yet one more possible vehicle or mechanism under which a dominant manufacturer can or can't exclude rivals.

It's one of several. Market-share discounts are the other category. You can't ban slotting allowances. I think what you have to do is narrow the criterion down sufficiently narrowly so you have a set of guidelines that get you into a very, very small number of good cases. I think that the guiding principle would be Bill Baxter's old principle which is, First do no harm.

MR. BALTO: Any other thoughts on the issue of remedy, what an effective remedy would be in the case where we found a slotting allowance problem?

MR. SKITOL: Incarcerate.

MR. BALTO: Of the enforcement --

MR. WARREN-BOULTON: Eat the product.

(Laughter.)

MR. BLOCH: David, how do you answer that question without knowing exactly what kind of problem you've found in this case? We've been discussing for two days, and I think that there are probably dozens if not hundreds of different kinds of problems that have been identified under this general rubric of either slotting allowances or, if you apply that narrowly to the new product introduction, to pay-to-stay, whatever it happens to be.

There's just dozens and dozens of problems that have come up here, and to say Well, what's the right remedy, I want to know what problem you want to fix.

MR. BALTO: Let me change the subject just briefly, and turn to category management. The last topic we'll get to will be the potential for guidelines and future study.

Are there any thoughts, based on the panel we just did, whether you think there's a problem with category management, what it might be, and how the enforcement agency should look at the practice?

MR. SCHMIDT: David, I have a thought.

MR. BALTO: Yes.

MR. SCHMIDT: It seems to me that what we heard on the last panel is that, as a general matter, category management is a positive for the industry. There are general problems that exist, that can exist in category management as they can exist with any other conduct.

And to the extent that there's an opportunity for additional training, as Chris suggested, I think this is an area where some informal guidance through speechmaking on Commission officials' part would be particularly appropriate.

Just some reminders, I think is what's necessary here. But I would just encourage you not to dampen something that is really a very significant positive within the industry by trying to do too much on the antitrust side.

MR. BALTO: Any other comments in this area? Chris?

MR. MACAVOY: Just I want to repeat that done correctly, it really does have the possibility of causing some of the slotting things to wither away, and therefore I think ought to be encouraged and certainly not dampened.

MR. BALTO: Would the two of you say that both slotting and category management try to address the problem of an information imbalance between manufacturers and retailers?

MR. MACAVOY: Well, yes, to some extent I agree with that. I think category management addresses that and is perhaps more positive and collaborative, collaborative in the good sense way. That's one of the main reasons why I think it ought to be encouraged. It is premised on information sharing.

Where there's information sharing there is need for antitrust counseling. But it really gets sharing of information in a positive way when it's done right.

MR. BALTO: That brings us to subject of guidelines. The Independent Bakers Association along with two other associations have submitted a proposal for guidelines. Alan Silberman has prepared a paper in which he's provided some thoughts about guidelines. I want to give each of them some time to talk about what they've submitted and their thoughts about what the best approach is in terms of guidelines.

Bob?

MR. SKITOL: You want me to start first?

MR. BALTO: Sure.

MR. SKITOL: I think there are a couple fundamental reasons why an FTC initiative to issue enforcement guidelines is a desirable thing to do for the guidance of the industry.

The first is, I think the record accumulated in this workshop, building upon the record from the Senate hearings and lots of other sources, indicates that there is a problem to be addressed here. We've heard a lot about slotting allowances being used in a wide variety of circumstances, not all good, not all bad.

But I think we've heard enough over the last couple of years in particular to know that there are lots of situations out there where slotting allowances are being misused with anti-competitive impact. This industry is now in a sort of anything-goes Wild West environment that is not good for the future of competition in this industry.

Second, and closely related to the first, one of the reasons why it is Wild West is because there is widespread disagreement and confusion throughout the industry over what the rules are, or indeed whether there are any rules.

At one extreme, there are lots of people in this industry who I think honestly believe, and have long believed, that the law doesn't apply to slotting fees. Slotting fees are per se legal. In fact at the Senate hearings a couple of witnesses basically said that relying on snippets and misinterpretations of things that different FTC officials have said over the years. That's just not true.

On the other hand, at the other extreme, there are people in this industry convinced that slotting fees in every shape and form and size are per se illegal. In fact, if one looks at some interpretations -- you know, I'm really disappointed, Irv and Ron, you guys talked about Section 2(a) and a lot of things. You didn't talk about Section 2(c) of the Robinson-Patman Act, and the fact is that there are precedents out there that, if you believe them to be valid interpretations of Section 2(c), illegal brokerage, would indicate that all slotting fees, particularly the one time payments for new product introduction, are illegal per se.

Well, that's ridiculous. That's not a good place for the law to be or a good place for people in the industry to think that that's what the law is, particularly when there is so much use of slotting fees going on out there.

FTC guidelines could serve the purpose of clarifying where the line is between lawful and unlawful, promoting an industry consensus toward a thoughtful and appropriate middle ground. There are lots of situations -- I mean to take the basic dichotomy that we started out with yesterday that Greg laid out from his survey, that there are efficiency stories and there are market power stories, and how do we distinguish the one from the other? That is something that a thoughtful set of FTC guidelines could do for the industry.

Now, as far as what the guidelines would do, I interpret everything that Rick Warren-Boulton has said today to be an endorsement of the particular proposed set of guidelines that we've come up with. They're not exactly, but pretty close to what he is advocating, I think.

We're not in favor of rules or anything intrusive. We're in favor of general guidelines, setting forth general principles with safety zones being exceptionally broad, and the actual indicia of enforcement concern being relatively narrow.

We start out by suggesting that these guidelines, and enforcement concerns generally about slotting fees, should only apply in situations where retailers and/or manufacturers involved in the practice have market power. Here I appreciate the point Rick was making about why do you need market power at the retailer level.

I think you do for a scenario that says there's going to be an anti-competitive effect at the retailer level. We'll come back to that in a second.

Our proposed guidelines draw a distinction between slotting allowances in the form of flat payments unrelated to volume, versus the per unit discounts. For the flat payment type, we've got major safety zones that basically say even the flat one-time payment deal ought to be presumptively lawful if it bears some reasonable relationship to new product costs, to the relevant costs involved.

And in that circumstance, there might still be a situation where , even though it's reasonable in amount, it's being used in a discriminatory manner. It's appropriate to look at the competitive implications of any discrimination that's involved or any exclusionary understandings. But the basic point is if there's some reasonable relationship to costs, it's presumptively lawful.

Then we say that if you're talking about the volume-related discounts, something that is really a whole lot more like regular price competition that we ought to really stay away from, then their our guidelines say, Hey, in that area it doesn't matter if it's related to costs or not, leave it alone, presumptively lawful without regard to relationship to costs.

Again, though, keep an eye on and recognize that even there that kind of allowance could run afoul of the Robinson-Patman Act. The Robinson-Patman Act is still on the books, and notwithstanding what most lawyers and economists think about it, it's the law of the land, and the industry ought to respect it.

Then we go on, and we talk about the importance of looking at exclusionary understandings and exclusionary effects. We talk about the payments for preferential shelf space and similar benefits, and that also should be renewed as an area of FTC enforcement concern because it's already in the Fred Meyer Guide's after all.

Those kind of payments are part of the overall competitive problem that exists in this industry that we've heard about in the last couple days.

Beyond all of that, the final note in our petition is that there's much too much secrecy about all of this, that it ought to be the case that manufacturers and retailers have some obligation to be public about their slotting fee policies, and how do we bring that about? Well, I think the FTC ought to consider dusting off its broad authority under Section 6(b) of the FTC Act and send out special reports to the 25 or 50 largest supermarket chains in the country, and the 25 or 50 largest grocery manufacturers in the country and get the information, get the goods, all of the hard data on exactly what's going on, write a report and make it public.

MR. BALTO: Thank you. By the way, I don't want to scare the business people in the audience, but when Bob started mentioning special reports, all of the lawyers at the table started to smile.

Let me turn to Alan Silberman, who also submitted written comments about the idea of guidelines and study.

MR. SILBERMAN: I fear you'll think I'm a little bit schizophrenic. Having said early on that I didn't think that it's a serious issue in terms of enforcement, at the same time I see some room here for guidelines, but they're guidelines of a different type.

If the standard for whether or not time should be spent on guidelines is the standard that Chris MacAvoy suggests -- that is, it's to act in a situation where the cop has not been on the beat -- then no, we don't need guidelines. The cop is on the beat. This workshop, if not also the McCormick case, shows us that.

If the point of it is to deal with the situation that there's a Wild West situation out there, as Bob suggests, the answer is no, there is no Wild West.

If the point of guidelines is to seriously work changes in the law, which is what I think the petition would suggest, not only in substantive law but also in a number of procedural points, I would of course be very much opposed to it.

So why do I think is room for guidelines? It goes back to what Bob Pitofsky said at the beginning of the workshop. There is a concept, you'll remember it from your conversation with Justice Brandeis -- there is a concept that says that the Commission is designed to give advice and guidance and improve the level of discourse on antitrust issues, that it has a didactic function as well. That I think guidelines can serve to move us ahead, to get us away from this talking about slotting allowances as a broad category, this aggregation of the topics, and begin to channel the discussion of both competition issues and policy and economic issues.

I think it would do so not just by getting us off the generic term slotting allowance, but also getting us to a point where we would recognize that what we are dealing with here is basically matters of price behavior, not promotional behavior, at least certainly in the new product introduction area. Therefore it gets us into meeting competition, functional differences and things of this sort, and could explore those topics, recognizing that our understanding today of meeting competition, for instance, is far different than it might have been 20 years ago.

We've heard testimony or comments during the last day and a half about how when you're competing for shelf space you're not merely competing against the same bottle of pickles or carrots or whatever -- that in fact the entire store from time to time is being maneuvered. You have the bidding competition situation we've talked about.

These are all areas that can be clarified. And existing legal principles about exclusionary conduct, about conspiracy, about other aspects of antitrust -- that those are sufficient already to deal with certain types of behavior that people around the table have thought of as slotting allowances.

I think the value of that kind of presentation, while perhaps not a guideline -- and by the way, this function could be performed by a Commission decision not to issue guidelines that has exactly the same content. In other words, it is entirely possible to perform the didactic role without going through the laborious process of negotiating, agreeing, getting the staff and everyone else to agree and getting the Commissioners to agree on guidelines, and rather to talk more generally why in certain areas guidelines are not necessary, but the didactic role here is crucial.

There are two areas where Bob and I think are on near common ground, not exactly but close. One, I do believe that there is an area for getting better empirical data here. If you go back to the literature, you go back to the 1975 period, and you find people saying, We don't know, we don't have real good information. We still have that. You had that in 1990. You have it now.

There is some empirical information that it would be really good to collect. I think part of the function there, while I would not make public a lot of confidential details, could be to give those category managers and other people in the retail and manufacturing side the data to help counter the bean counters.

In other words, there's a great deal of behavior here that is being driven, not by good marketing decisions and by and for marketing decisions, but by accountants who have decided that this goes to the bottom line this way, this goes that way, classify this that way, and everyone around the table keeps saying, Well, look, because of that price doesn't change.

That's nonsense in a broad sense. It's probably very true in a daily sense. One of the things the Commission does is help raise the level of business behavior, and it can do that with information.

The one point where Bob and I agree partially is on transparency. I believe that transparency extends only on the terms on which firms negotiate various kinds of, quote, slotting allowances and so on, not to the actual end results of negotiations.

Bob would go all the way, but I believe that the Commission could express somewhere along the way a preference, not to say that the opposite is illegal or deals in inference the other way, but a preference for transparency.

If indeed the things we were talking about here really do promote effective functioning of the marketplace, then there should really be no problem about saying, We negotiate or we don't negotiate or people come and can make a presentation and get in on 20 stores in the city, things like that. Those things ought to be out in the public.

MR. BALTO: Ron?

MR. BLOCH: Some day maybe guidelines of the kind that Bob has proposed might be appropriate, and maybe even those guidelines. I think we need some evidence beforehand to show that market power exists both at the manufacturer level and at the retail level at 20 percent market share in virtually all markets in order to establish the kind of a bright line test that is contained in the guidelines. I don't think there is much evidence to support that 20 percent test yet.

And whether this is the right time to issue guidelines, it seems to me that the Commission needs a tremendous amount of knowledge, understanding and experience with the subject of the guidelines. The subject of the guidelines is slotting allowances. If the FTC had that level of knowledge, understanding and experience, we wouldn't have been here for two days.

This is the beginning of the learning curve, and the beginning of the learning curve is hardly the time to issue guidelines in the form that you have proposed, which will be argued as the state of the law any time an issue of this nature gets before a judge.

And the Commission needs a much greater level of knowledge and understanding before it comes out with that kind of a concrete legal-and-illegal pronouncement.

Specifically I think there are a few other problems with these guidelines; namely, they cover much more than new product introductions. If you look at the language, it deals with acceptance, stacking, display and other favorable treatment. Well, that creates a tremendous overlap with the existing Fred Meyer Guides, and I don't think we need that kind of overlap if we're dealing with what is supposed to be a different problem.

I think that today the 20 percent guideline for market power, the line between when you can and when you can't is basically arbitrary. It doesn't have any factual support, and I don't know of a single case that suggests that anybody either at the retail level or at the manufacturing level had market power at 20 percent.

MR. SCHER: Toys R' Us. 17 percent.

MR. BLOCH: 17, all right.

MR. BALTO: But much higher in certain metropolitan markets.

MR. SCHER: It was a national market in the case.

MR. BLOCH: Let me get to what I see as probably an overarching point about guidelines. Guidelines -- and I think our experience has proved this -- guidelines really are worthless if they just sit out there in a book as words on a page. For them to have any effect whatsoever, they need to be enforced.

Now, look at the status today of the Fred Meyer Guides. There hasn't been a case to enforce those guides since 1990 when the Commission went through a very expensive revision of those guides with public comments and all that goes with it, and they have been nothing more than words in Part 240 of the Federal Regulations, 16 CFR if I recall correctly.

Why in the world would the guidelines that you are proposing, or any other guidelines to define the conduct that's illegal and what is legal, why would they be given any more attention than the Fred Meyer Guides are given to date? They are, to be brutally frank, the biggest joke in the grocery business that exists, because the FTC has shown no intention whatsoever of ever enforcing them.

Well, unless the Commission intends to enforce slotting allowance guidelines there's no point in bringing them out. There's nothing to be gained as a practical matter by going through the exercise.

So I think what we need, if there are problems to be addressed, competitive problems, whatever they are, by guidelines, the first step is, Bring some cases to show the world on a litigated record, Here's the problem, it causes competitive injury. And then when you build up a backlog of that kind of experience like we had with advertising and promotional allowance, it went to the Supreme Court, we had the development of some jurisprudence and then came the guidelines.

I think that's the proper approach, if and when guidelines to deal with slotting allowances or anything else are to be promulgated. In the meantime, I think if there are problems to be addressed because they injure competition, then the approach for now is to bring a case or a series of cases.

MR. BALTO: I have to step out of role and reply to Ron. I'm the person that receives the various complaints, requests for investigations, enforcement action in the Bureau of Competition, and we do not receive complaints in the area of the promotional programs covered under the Fred Meyer Guides.

Yet at the same time I observe that there are lots of programs going on in this area. There's lots of counseling that goes on in this area, and we did go and talk to people, including the lawyers at various manufacturers, in the course of our interviews.

I guess my assessment would be that this is a good example of where the private bar serves an important role through guidance in making sure that their clients stay within the lines. If someone has a good matter that they believe violates the Fred Meyer Guides, bring it to my attention. We'll look at it immediately. Dick Steuer?

MR. STEUER: I think it would be a mistake to bring out guidelines in this area, actually now or ever, and the reason I feel that way is that the notion of slotting allowances is really a misnomer. It includes things that are very well addressed in other areas of the law, particularly exclusive dealing but also the Robinson-Patman aspects, and it's organic.

I had a colleague who used to compare this to a game called whack-a-mole. As soon as you knocked one down another would pop up. Guidelines simply are not nimble enough to change the way the case law can, and to the extent that there were problems here, most of the problems we talked about involve exclusivity, some Robinson-Patman.

These things can be addressed on a much more immediate basis. There are too many things going on under this category to really be a category, any more than left handed distribution restraints would be. You've got customer initiated programs, manufacture initiated programs, placement programs, entry programs, exclusion programs.

I think that it simply doesn't lend itself to guidelines, although I must disagree with Ron. I think that the Fred Meyer Guides are an area where, although maybe they don't come up in litigation very often, I think in offices all over corporate America these things are referred to every day, and you get feedback on it all the time.

MR. BALTO: Chris MacAvoy, I don't think you're about to welcome the guidelines.

MR. MACAVOY: On that latter point, some of you may have seen the little ABA Antitrust publication, it's a brief guide to the Robinson-Patman Act, that is the largest selling publication that the ABA Antitrust Section has. It's a fact of life to comply with the Robinson-Patman Act for businesses all over the country.

On guidelines, I agree that I don't see the desirability, the wisdom of guides in the sense that Bob Skitol has proposed. Alan Silberman's idea of something having a more didactic function, maybe, although I'm very interested in the comment he made right at the end about how we need more transparency.

I represent a trade association of retailers. I see Jeff Schmidt down here who does work for a manufacturer's trade association. I know at our meetings we don't talk about slotting allowances. We don't put our slotting allowance policies on our web sites. The Commission expressing a preference for transparency, that doesn't give my guys antitrust immunity, so I mean, that's just a baseline problem for us.

People say, What is your trade association client's policy on slotting allowances. There isn't one for good reason.

MR. BALTO: By the way, in the middle of Steve Salop's paper, there is a discussion of why horizontal agreements to control slotting allowances should be analyzed under the Rule of Reason.

Alan?

MR. SILBERMAN: I probably ought to amend my position to be one for seeking guidance rather than guidelines, but I think we should recognize that we all pay a price when there's a lack of adequate guidance. We have to remember that it is not merely the Federal Trade Commission that enforces the law or for that matter the Federal Trade Commission, the Department of Justice and even State Attorneys General. There are various state statutes -- some generically worded like thou shall do no bad thing, which is in fact a statute in several states -- that lead various individuals to say, Well, this is a bad thing, let's go ahead and litigate it.

Let's have a jury decide in some state court in the middle of one of the 50 states. There are even some states that have statutes that could be interpreted to say, sort of following along with what Chris is saying, that every buyer and seller should announce the terms of every transaction that they make, even if they're perfectly lawful, even if they're meeting competition or whatever else, so that the world knows about them instantaneously, a process which I think would easily be characterized as an invitation to conspire.

But there are state statutes which some lawyers would interpret as saying, If you don't do that, it's secret and secret is wrong. There's a little theme of that in Bob's guidelines.

Now, that's what happens when you have a void, so we've got to fill the void. We have to fill it with good data. Ron, absolutely right about that. But we ought to recognize that right now we have a big void.

MR. BALTO: Rick?

MR. WARREN-BOULTON: I guess several points. First of all, I think like every single person around this table, I think that guidelines would be desirable if I wrote them.

MR. SKITOL: Most of us think you should write them.

MR. WARREN-BOULTON: The problem is what do we do if we can't write them. Do we want the FTC to write them? People may have missed that of the four criteria we discussed, the case against McCormick would have flunked two of them. So the guidelines I would write would clearly state that -- McCormick would not have been accused of anti-competitive behavior through offering slotting allowances.

And so I think to your point, when you don't trust individuals to do it, the other way to do it is you go through the extraordinary expense and time-consuming process of litigation. I mean, it's sort of like the quip about democracy. It's just horrendous, but everything else is worse. It's a very expensive way to get out guidelines through litigation.

So you really have to mistrust the analytical process a great deal to decide to go that route. You may well be right, and I share your concern about bad guidelines, so clearly I think we would all agree that bad guidelines are worse than no guidelines, and my guidelines are better than no guidelines.

The second thing to say is I think there's now I think a real consensus in the economics profession that exclusion is a real concern and a real problem and Chicago is dead on this issue. And so I think there's a real problem here that needs to be addressed. That's a plus.

Another plus, point 3, is that I think you really can come up with a set of narrowly defined conditions which will lead you to a fairly small set of cases where in economist terms your false positive rate is low. You have a fairly low chance of convicting the innocent, okay?

But the other point, which somebody made over here, which I think is really very true, is this is not a slotting allowance issue. This is a generic problem of exclusion by a dominant manufacturer, and slotting allowances are just one manifestation from it. Someone said organic. I don't remember who said that, but that was really quite good. One of the problems is, as with most kind of vertical restraints and other things, if you ban one kind of vertical restraint you'll get another.

Well, it turns out that for nearly every anti-competitive act I know there's at least a dozen ways to do it. You're missing out on some, give me a call, and I'll give you another seven or eight ways to do it.

So the question I think the FTC has to address is, do they want to write what are basically exclusion guidelines or is there something separate here about slotting allowances truly?

That being said, I would also say finally, I think one of the functions of the FTC is there are empirical tests you can do. We've talked a lot about stuff. There are hypotheses floating around all over the place. Most of those hypotheses are testable, and it seems to me that it would be very worthwhile to answer some of the questions that are floating around.

The two that came up just this afternoon are, What happens when you have mergers? Do you get more slotting allowances or less slotting allowances? When can we distinguish between mergers creating buyer power, which is good, and mergers creating market power -- so these are all subject to empirical verification.

It seems to me that one of the functions, maybe even before guidelines are issued, would be to sit down and say, What are the testable implications of the various theories, and let's go ahead and test them because certainly you have data. You have IRI data, you have Nielson data. This is not hard to do. It doesn't take an economist. It doesn't even take a rocket scientist. Even an economist can do this sort of thing. I think it's a research agenda that you're looking at.

MR. BALTO: By the way, for an economist you don't seem to count very well. After we're done I'll explain that McCormick does meet all four of the standards that you've articulated.

Jeff Schmidt?

MR. SCHMIDT: David, I share the view that guidelines are not necessary here, really just quickly, for two reasons. One, the point has already been expressed that the existing legal tools are adequate to deal with the problem. But one point that I don't think has been adequately emphasized is, I see a tremendous effort within the industry working on this as well as a number of other problems within the grocery industry, work that's gone on between manufacturers and their trading partners on the retail level on a one-on-one basis.

We had a panel talking about category management, which really is an outgrow of that joint industry effort to try to get to a more fact based analysis and a more efficient way of conducting business. I think a tremendous amount of work has gone on with respect to activity based costing which also will be helpful on this. All of this at least suggests to me that the industry, for a number of reasons, is really beginning to tackle and may well be well on its way of tackling this as well as other issues that can create problems within the industry.

MS. DESANTI: I would just like -- Bob, go ahead. You want to respond to some of these points that have been made.

MR. SKITOL: I'm going to stand on the petition we filed as a basic response to most of the comments that have been made on the other side and I won't repeat. But to make one point that there are various and sundry ways of providing public guidance, this is one of the points I agree with. One of them is whatever it is that the Commission staff decides to do in the aftermath of this workshop by way of a written report, I think that you guys have really done a tremendous job of collecting information and perspectives over the last couple months and over the last couple days.

And whether or not in the aftermath you and the Commission ought to proceed with the research agenda and/or to proceed with guidelines of the sort that my clients are urging, at a minimum I would respectfully urge that the Commission staff and the Commission prepare and issue a public report setting forth some findings and conclusions and perspectives that have come out of this workshop. I have feeling if that report is done in a thoughtful way, the report in and of itself will be an important form of public guidance that the industry will appreciate.

MS. DESANTI: Thank you, Bob. I guess I want to put this whole discussion that we've been having for the last half hour or so in the context of the limited resources that the FTC has. You're right, Rick, it may be that even economists can do the kinds of data collection and data analysis that are necessary to answer some of the empirical questions that come up, but it costs money, and we are all faced with a question of, compared to what?

Compared to investigations? Compared to guidelines? I personally have way more experience than I ever wanted to get in drafting guidelines and negotiating guidelines, and it's a hugely costly process in terms of staff, time and effort, in terms of data collection, empirical study, research. So I'm interested in the views of all of you. If you only had to choose one of those directions to go in, because you have limited resources, and we are after all still in the midst of a merger wave, where would you go?

MR. WARREN-BOULTON: Can I make a comment? There's an inexhaustible supply out there writing Ph.D.s and looking for good topics. This a cheap free labor, and I think one possible solution to this is in fact for the FTC to sort of contact its, shall we say, academic network and say to them, Look, here are ten terrific Ph.D.s topics. Those of us who are academics for many years know that there are hundreds and hundreds of kids who are thrashing around sleepless nights, What the hell am I going to do for a topic?

And you have some great topics. It would be a little slow, going in the wrong direction, but it's real cheap.

MR. SKITOL: But how about if the Commission helps out the academics with some subpoenas for serious hard data?

MR. WARREN-BOULTON: You don't need that, IRI and Nielson all that data is out here.

MR. SKITOL: That doesn't give you serious cost information about --

MR. WARREN-BOULTON: Okay, yes.

MR. BALTO: Can I turn to our two other

economists. First Mary Sullivan.

MS. SULLIVAN: I think the data-collection aspect of the study is a little more difficult than you think just going in. I think getting the scanner data is one thing, but going in and trying to collect information on the fees and other variables you might need could be a little more challenging than a graduate student could start with. So I'll say, having thought about doing slotting allowance studies for a long time and having done one, I'm pretty pessimistic, and think maybe the FTC should be in charge of at least the data collection.

But having listened to the panels for the past couple of days, there are three basic kinds of studies I would do if it were up to me. I think one of the big policy issues concerns whether slotting allowances or these fees are mainly a phenomena of new product introductions or whether they involve other things that happen after the new products is introduced.

I know one of the great stylized facts of marketing is, over the past 20 years, the sort of percentage of what manufacturers pay for advertising and promotion has gone much more towards promotion and away from advertising, so it seems like a lot of different kinds of fees have increased.

So I think one good study would be just to look, maybe at the category level, at fees that are paid for new products versus fees that are paid for products that other stages in the life cycle, older products according to their performance or expected performance or things like that. This would just let us see, Well is there really a problem? Are fees really important in other stages of the life cycle other than when new products are introduced? I think that would be really useful.

There are a couple other studies that I think would be really interesting. One of them basically would have to do with understanding retailer's buying decision, What makes a retailer decide to accept a new product, and how do the fees affect that, and are small manufacturers somehow disadvantaged? So do small manufacturers with products that look like they're going to be very successful, are they less likely to be than established manufacturers' products? Just things like this would be things that we would need to understand.

The third study I would do concerns understanding product failure. I think product failure is a rather ambiguous term, but what you want to look at is, What are the circumstances under which a retailer decides to take a product off the shelf, and is that related in some way to fees that were paid by other manufacturers, and are there dominant manufacturers, and how many manufacturers are there in the category?

So those are the three basic studies I would do. Again, I'm sort of the pessimistic about the data requirements, but you'll worry about that.

MR. BALTO: Greg Gundlach?

MR. GUNDLACH: I want to make a couple comments just with regard to where we go from here. I think the acknowledgment that the lack of information that we have really sets the agenda. I think it's in a sense premature to talk about guidelines until we know what we're talking about, and in that respect, research is needed.

The amount of research we have right now is much about anecdotals. It's much about opinions of manufacturers and players in the industry, and there's very little hard empirical data out there that helps us either at the academic side or in the professional arena.

The challenge, however, the wall we face as a research group in trying to gather this data is the cooperation to obtain that data. Until that wall is broken down we are not going to be able to some of these empirical questions that we've been talking about for the last two days.

As far as where we go, if we get over that hurdle, I think getting descriptive data so that we have a sense of what these different fees are and how they are played out in the arena is very important. I think, as many have talked about today, there's a variety of different theories out there that we can begin to test through a rigorous econometric and other means, and so heading in those three directions I think would be helpful.

MR. BALTO: Mark Gidley?

MR. GIDLEY: I'm not in favor of guidelines, as you might have suspected. I do think that the conference has been worthwhile, and I think that it's very likely, knowing how prolific you are, David, and that's to your credit and the Commission's lucky to have you, that at a minimum we're doing to see at least one grumpy speech out of the FTC about slotting allowances. You snicker, but that gets faxed to every client. It's disseminated to every category manager.

Those things filter down, so if nothing else I know that you're a bright fellow and you have enough material for at least one grumpy speech, and that will start a dialogue, and the speech is a far cry from guidelines, but if you make a mistake in guidelines you start freezing retailing and retail formats.

This country is blessed with the best retailers in the world. We have Home Depot, Wal-Mart, Costco, all these wonderful retail formats. They're invading Europe. You don't see European manufacturers coming in here with the exception of Trader Joes and Aldy's, that is basically all we're getting from Europe. And Europe is much more regulated. They regulate hours. You have to about open at seven in the morning. They prevent discounting. They prevent big box stores, so I think you have to be very careful before we tinker with the playing field.

The third thing I would say is I think it's important that whatever speech, position, thoughts, the Warren-Boulton school of sort of the monopoly dominant manufacturer, whatever you ultimately conclude is your biggest law-enforcement problem, I would make sure that the guidance is universal, that it can work in all retail formats.

There's no reason to limit it to supermarkets. Supermarkets are converging with other retail formats, and if you want to look at buyer power, there are two national hardware chain. We've got scores of supermarkets chains. If you believe office superstores are a separate market, we have three of those. I understand drug stores have used slotting allowances for many years.

So I think that your guidelines are going to be interpreting laws that apply to all retailing, and they have to be able to withstand the rigor of working in those markets, and I know that you've groaned when I broaden this debate, but honestly the law is the law. Your policy, your Section 5, your Justice Brandeis kind of concept of this place, has to work across all American retailing, and I would say, First do no harm. Start putting out in the public record some of the things that concern you.

You spend a lot of time with us. I don't think you begin to understand our business. That's not a criticism, but it's highly complex behavior you're dealing with.

MR. BALTO: Irv Scher?

MR. SCHER: I want to say a couple things. I agree with virtually everything Mark said, but I also agree with Ron that the way to go here probably is with cases, and I would commend to the Commission an article called Tom, Balto and Averitt, Anticompetitive Aspects of Market Share Discounts, et cetera, because I think that's what we've been hearing from the economists today. Exclusionary conduct, vertical exclusionary conduct by dominant companies, is what the Commission should be looking at, and under basic Sherman Act rule of reason concepts, exclusive-dealing rule of reason.

MR. BALTO: Chris MacAvoy.

MR. MACAVOY: The call has gone out from a couple corners here for more data and a couple of people said, Hey, send them subpoenas. I don't want to get carried away with that type of thing. Mark Gidley and I have both gone through a number of second request compliances in supermarket deals. They cost about 750,000 to a million dollars a pop for a regional supermarket deal.

MR. BALTO: Are there any lawyers here who can undercut that price?

MR. MACAVOY: I have an outline of questions that I use to prepare for investigational hearings in supermarket mergers. It's not an outline that's changed much over the years, but I have in the last year or so added a section on slotting allowances as we start to get asked those questions in hearings.

The second requests get longer every year. I would be dismayed, although part of me would be delighted, to flip over the next second request I might receive and see "Part 5 -- Slotting." I'm very sympathetic to the statements made about the lack of resources to do this kind of thing, but it costs somebody money when subpoenas go flying.

MR. BALTO: Does anybody have any additional comments they would like to make?

Well, I wanted to thank everybody for participating and listening so patiently. This has been a fantastic experience, one in which I think the Commission staff has learned a great deal. I want to thank all my colleagues.

I want to thank especially the over 80 manufacturers and retailers who were able to provide us information on a voluntary, confidential basis, and a number of them who walked us through their stores. I most of all want to thank every one of the businessmen who, at their own expense, and on their own time, came out to join us for the past two days. Thank you very much.

(Time noted: 5:10.)

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C E R T I F I C A T I O N   O F   R E P O R T E R

CASE TITLE: SLOTTING WORKSHOP
HEARING DATE: JUNE 1, 2000

I HEREBY CERTIFY that the transcript contained herein is a full and accurate transcript of the notes taken by me at the hearing on the above cause before the FEDERAL TRADE COMMISSION to the best of my knowledge and belief.

DATED: JUNE 19, 2000

Debra L. Maheux

DEBRA L. MAHEUX

C E R T I F I C A T I O N   O F   P R O O F R E A D E R

I HEREBY CERTIFY that I proofread the transcript for accuracy in spelling, hyphenation, punctuation and format.

DIANE QUADE

Slotting Allowances and the Antitrust Laws

Testimony of
The Federal Trade Commission

presented by
Willard K. Tom, Deputy Director
Bureau of Competition

before the
Committee on the Judiciary
U.S. House of Representatives

Washington, D.C.

October 20, 1999

Mr. Chairman and Members of the Committee, my name is Willard K. Tom and I am the Deputy Director of the FTC's Bureau of Competition. I appreciate the opportunity to testify before you today about competition issues in agriculture and food marketing. I understand that other witnesses will address specific questions involving packers and stockyards, an area over which our jurisdiction is extremely limited in any event. I will focus instead on the way that slotting agreements are assessed under the antitrust laws. My written testimony states the views of the Federal Trade Commission on this subject, but my oral presentation and my answers to any questions that you ask will be my own. Let me add that the Commission has at least one nonpublic law enforcement investigation pending in this area, and so I respectfully request your indulgence if I don't reveal the investigative details.

The Federal Trade Commission is an independent agency that has the mission of ensuring that consumers have the benefits of free and fair competition. We enforce a number of antitrust statutes, such as the FTC Act and the Clayton Act with its merger provisions, which ensure that the marketplace remains competitive. We also enforce a number of consumer-protection statutes, which ensure that customers can make their selections in the marketplace on the basis of accurate rather than of deceptive information. Working together, the two main missions of the FTC ensure that consumers are able to go into a competitive marketplace and make free choices there.

Today's hearing asks how slotting allowances should be assessed within this framework. The term "slotting allowance" typically refers to a lump-sum, up-front payment that a food manufacturer must pay to a supermarket for access to its shelves. The term has been used to cover an extremely broad range of conduct, some of it clearly unlawful, some clearly lawful, and a great deal of it in the gray area in between, the legality of which can be determined only in light of all the surrounding facts and circumstances.

At the clearly unlawful end of the spectrum is commercial bribery. This is an under-the-table payment to a purchasing agent of a retailer that goes straight into the agent's pocket, in violation of the fiduciary duties owed by the agent to his principal. Allegations of this sort have arisen in public discussions of the issue, such as the recent hearings held by the Senate Committee on Small Business.[(1)] If such instances come to our attention, we will promptly refer the matter to the relevant state or local authorities for criminal prosecution. Only criminal sanctions can provide adequate deterrence for this sort of covert, blatantly illegal conduct, and it would not be appropriate for us to try to apply antitrust standards and remedies to conduct that is universally condemned for reasons wholly apart from antitrust.

At the other end of the spectrum are payments from a manufacturer to a retailer that really constitute only an ordinary price discount. For example, a short-term agreement for advance payments that does nothing more than obligate the retailer either to buy a certain number of units of a manufacturer's product or to return a proportionate share of the advance payment may be little different from a simple price cut. In such a situation, the retailer gets, in effect, a certain per-unit discount off the nominal selling price. The only difference is that the retailer receives the discount at the outset of the contract. If the retail market is competitive - a very important precondition - the discount is likely to be passed through to consumers and competition will not ordinarily be harmed.

In between these two extremes is a gray area. We have heard on occasion from small manufacturers that complain about activity in this area. For example, they have reported that strong buyers, such as supermarket chains, are demanding large up-front payments not tied to volume. In some cases, we have been told, these allowances are so large that some small manufacturers cannot afford them and are dropped from the store.

When we evaluate this kind of conduct, the antitrust statutes require us to determine whether particular actions have harmed the overall level of competition in a market. If a market can be kept competitive, then consumers will receive the benefits of low prices and wide product selection, and businesses will receive the benefits of having many suppliers and many outlets.

In light of this principle, how do we determine when slotting allowances have actually put competition at risk? And what should an antitrust agency do to prevent or remedy such situations?

Evaluating Slotting Allowances

The first question is how to determine when slotting allowances have actually had a harmful effect on competition. Unfortunately, the answer, as for many economic practices, is that it depends on the circumstances. Very often debates over slotting allowances have assumed that all slotting allowances, and all of the market conditions in which they are used, are the same. Life would be a lot simpler both for law enforcers and for legislators if only that were so. But in fact there are significant differences both in the terms of the allowances, and in the contexts where they are used.

First, there are differences in the terms of the slotting allowances themselves. The actual allowances -- the payment from manufacturer to retailer -- are one side of a bargain, the other side of which can offer tremendous variety. What does the retailer offer in exchange for the payment?

- Is it a payment simply to be carried somewhere in the store?
- Is it for a fixed amount of shelf space?
- Is it for preferential display -- the end-caps or eye-level shelves?
- Is it for the right to be the exclusive, or nearly exclusive, supplier in that product category?
- Is it for the right to control what other products in that category will be allowed on the shelves?
- And is it for a long or a short time?

The answers to these questions can have a major effect on how much room is left for other suppliers in the market, and therefore on whether the allowances are harmful or innocuous, procompetitive or anticompetitive.

Thus, if a dominant manufacturer, in exchange for slotting allowances, secures promises from a large number of retailers not to carry the products of its competitors, competition might be seriously harmed. Indeed, if so many retailers were tied up by these contracts that competing manufacturers could not secure enough distribution to stay in business, outright monopoly could be the result.

Similarly, if a dominant manufacturer or a small group of manufacturers were able to secure exclusive arrangements with all the desirable retailers, thus forcing other competitors to use only less desirable retailers, they might be able to raise prices because they would face less effective competition.

Even without 100% exclusivity, a manufacturer or a group of manufacturers might be able to marginalize their competitors and lessen the competition they face through partial exclusivity requirements that, for example, guarantee the manufacturer (or the group) a large percentage of shelf space or give it a veto right over other manufacturers' products.

On the other hand, payments of reasonable amounts to compensate the retailer for the costs and risks of stocking a new, unproven product, without exclusivity requirements, are unlikely to harm competition. This was the original context for the term "slotting allowances." Taking on a new product confronts the retailer with not only the actual costs of restocking shelves, changing labels, and reprogramming scanner equipment, but also the potential costs of product failure and being left with unsold inventory. Moreover, taking on a new product often means that some other product must be dropped from a store. The average supermarket stocks 30,000 items, but fully 100,000 grocery products are available from manufacturers, and another 10-15,000 new ones are offered each year. Supermarkets cannot stock all the available products, and when a new product comes in, that typically means an old product must go. Under those circumstances, it may be reasonable to ask the manufacturer, which has usually done the test-marketing and has the best information about the potential of each individual product, to bear some of the supermarket's risk if it wants to persuade the supermarket to try the product.(2) Such an arrangement may be reasonable if the payments are roughly equal to the risk-adjusted costs involved.

So far we've been talking about the different kinds of slotting allowances and associated agreements. In addition, the market circumstances in which the agreements take place can vary widely, and with equally important consequences.

The Supreme Court has told us that even outright exclusive dealing agreements can be lawful and procompetitive where markets are relatively unconcentrated.(3) Exclusive arrangements between a manufacturer and a retailer may help them work together to compete more effectively against other manufacturer-retailer pairs. The retailer that is specializing in the product of one supplier can become more familiar with it, better able to convince customers of its merits, more motivated to sell it, and better able to service it. And as long as there are many comparable manufacturers and many equivalent outlets for their products, and as long as only relatively few outlets are needed to reach nearly all of the end user customers, competition should be vigorous, notwithstanding the exclusive contracts. Consumers will still have multiple brands to choose from and manufacturers will have multiple routes to the marketplace.

Conversely, when the market is highly concentrated in the hands of one or a few firms, or when one can compete only if one has access to most of the outlets in the market, anticompetitive effects become more likely. If one supplier has exclusive contracts with all or most of the outlets in a market, and especially if slotting fees are paid to maintain an existing product line rather than to introduce a new one, competition can be diminished in terms of both variety and price. Competition can be diminished in terms of variety, because other suppliers cannot easily find enough outlets to become an effective presence in the market, and because shoppers will have difficulty locating those products even if they are available somewhere. It can be diminished in terms of price, because all products are likely to be more expensive as a result of the lessened rivalry among manufacturers.

To see if these outcomes are likely, the Commission looks at concentration at both the manufacturer and the retail levels. Dominant manufacturers are more likely to have the ability to engage in the kinds of exclusive dealing strategies outlined above, even if retailing is fairly unconcentrated. Similarly, when a handful of companies dominate retailing of particular types of products, they are more likely to be able to impose terms such as slotting allowances, and also more likely to have only limited competition among themselves at the retail level, so that they are more likely to retain the slotting allowance as a bonus for themselves, rather than being induced by the competitive environment to pass it on as a cost saving to consumers.

Enforcement Approaches to Slotting Allowances

Given that slotting allowances can have such varied effects in various circumstances, how should an antitrust enforcement agency approach the issue, and how should it deal with those problems that do exist?

The first and most important step is surely merger enforcement. It is when either manufacturing or retailing becomes highly concentrated that we see the greatest potential for practices such as slotting allowances to have anti-consumer rather than pro-consumer effects. Merger enforcement is one way of setting some limits on increasing concentration.

As everyone in this room knows, we have been in the midst of an enormous merger wave for some time now. Merger transactions reported under the Hart-Scott-Rodino Act have increased from 1529 in fiscal 1991 to 4679 last year, with no end in sight. The antitrust agencies have handled this dramatic increase in mergers with, at best, a modest increase in budget. Although this has put an obvious strain on Commission resources, the agency has been able to continue ferreting out the relatively few mergers that may harm competition, and has blocked or restructured them so that the interests of consumers are protected.

This merger program has been active at the retail level as well as at the manufacturer level. In recent decades the conventional wisdom was that retailing was characterized by a great deal of competition and low barriers to entry, so that few mergers there were likely to be anticompetitive. The retail world has been changing, however. When the agency investigated the proposed merger of Staples and Office Depot, the two largest of only three national office supply superstore chains, we learned that non-superstore retailers did not exercise a significant competitive constraint on these chains. Instead, we found that the chains were a market unto themselves. Consumer prices were higher in markets that had only two chains rather than three, and higher still in markets that had only one, regardless of what other types of outlets were present. Even the presence of Wal-Mart or other general merchandise discounters did not alter this fact. The Commission therefore successfully challenged the proposed merger in court.(4)

In grocery retailing, the agency maintains a very active program of merger enforcement. In the last four and a half years the Commission has brought enforcement actions in 10 major supermarket mergers. These cases have resulted in the divestiture of 277 individual supermarkets or building sites. One of the agency's most recent matters of this sort involved Albertson's acquisition of American Stores. The consent agreement in that one case alone calls for the divestiture of 144 supermarkets and 5 building sites, generally to smaller chains or to independent wholesalers.

In addition to merger enforcement, we also scrutinize agreements -- including agreements on slotting allowances -- where the restraints and market structure seem likely to produce anticompetitive effects. One such case involved a powerful retailer demanding the kind of exclusivity that we sometimes see associated with slotting allowances. This is the case against Toys 'R' Us, now on appeal before the Seventh Circuit.(5) In that case, the

Commission found, among other theories of violation, that Toys 'R' Us used its power as a retailer to orchestrate a conspiracy among large toy manufacturers to withhold the more desirable toys from the lower-cost warehouse clubs against which Toys 'R' Us competed. By enlisting the manufacturers into the conspiracy, it was able to weaken the warehouse clubs as competitors in the retail market. In reaching its conclusion, the Commission carefully examined, and rejected, a variety of efficiency defenses that Toys 'R' Us offered to justify its conduct. The evidentiary record gave the Commission a high degree of confidence that Toys 'R' Us's practices were what they seemed to be -- a way of cutting off supplies to rivals in order to relieve the competitive pressure that had produced benefits for consumers. Controlling practices of this kind can go a long way toward ensuring a competitive landscape.

The Commission is committed to pursuing anticompetitive practices vigorously. The Commission recognizes that competition is at least potentially harmed, not only in the commercial bribery situations alluded to earlier, but also in cases where the slotting payments are associated with predatory pricing, price and other forms of discrimination, monopolization, or raising the distribution costs of rivals in order to make them less effective constraints on a dominant manufacturer's pricing. We remain alert to the possibility of harm in all these circumstances.

Conclusion

To sum up, the term "slotting allowances" covers a wide variety of practices under a wide variety of market circumstances, and the competitive effects are not always clear-cut. But five specific points can be fairly made in closing.

First, the Commission, under its statutes, looks to determine whether particular conduct has harmed the overall level of competition; this means that harm to an individual competitor is not necessarily an antitrust violation. Second, in practical effect some slotting allowances can be discounts off of list price and beneficial to competition, particularly when they are passed on to consumers. Third, the FTC nonetheless considers complaints about particular slotting allowances very carefully, precisely because their market effects can be so different. Fourth, the FTC does not receive many complaints in this area - perhaps one every three months on average.

Fifth, however, the FTC remains committed to pursuing evidence of antitrust violations when it finds them, and welcomes hearing from anyone who may be aware of such evidence. We would like to affirmatively encourage this by assuring small manufacturers that we are aware of their concerns about the possible business repercussions of complaining to the government, and that, accordingly, we always hold the names of complainants in confidence. We also look forward to working with this Committee as it continues to study this complex subject.

Thank you again for this opportunity to present the Commission's views.

Endnotes:

1. "Slotting: Fair for Small Businesses & Consumers?," Hearings before the Committee on Small Business, United States Senate (Sept. 14, 1999).

2. Another way this has been expressed is that the manufacturer's willingness to "put its money where its mouth is" signals a greater likelihood that the product actually will succeed.

3. *See, e.g.,* Standard Oil Co. v. United States, 337 U.S. 293 (1949).

4. *FTC v. Staples, Inc.*, 970 F. Supp. 1066 (D.D.C. 1997). In recent years the Commission has also devoted significant enforcement resources to mergers of consumer product manufacturers. *See, e.g.,* S. C. Johnson, FTC Dkt. No. C-3802 (acquisition of DowBrands conditioned on divestiture of "Spray 'n Wash," "Spray 'n Starch," and "Glass Plus" brands) (consent order) (1998).

5. FTC Dkt. No. 9278 (Opinion and Final Order, Oct. 13, 1998) (Comm'r Swindle concurring in part and dissenting in part), *appeal filed*, Dkt. No. 98-4107 (7th Cir., filed Dec. 7, 1998).

Senator Dianne Feinstein
Statement for the Record on Slotting Fees
United States Senate Committee on Small Business
September 14, 2000

Mr. Chairman, I appreciate the opportunity to submit testimony at this hearing of the Small Business Committee.

I commend the Committee's continuing interest and work to explore the impact of slotting fees on small manufacturers and producers. I understand the term of "slotting fees" as fees paid by agricultural suppliers and manufacturers of consumer food products to retailers to place and keep their products on the grocery retailers' shelves. As California is the nation's top agricultural supplier (with an estimated $25.9 billion agricultural production and income), this issue has particular relevance for my state.

Over the past several months, some of California's top agricultural associations have contacted my office with concerns that the practice of slotting fees 1) restrains competition; 2) drives the cost of agricultural products up while significantly reducing customer choice; and 3) creates monopolies. Produce sellers have a heightened sensitivity to this practice because of the limited number of markets available for their perishable and price-sensitive products.

Let me give you an example of these inquiries. My office was recently contacted by Ms. Carmela Cantisani, the owner of Carmela's Gourmet, a small company located in Monterey, California that produces a line of gourmet salad dressings. Ms. Cantisani opened this business in 1993 and says the success of her enterprise has been threatened by the practice of slotting fees.

Carmela says that she was charged $3,000 to place four of her six flavors of gourmet salad dressing on the shelves of a grocery store chain in Southern California. In less than six months, they discontinued her product. Through re-negotiation, two flavors were placed back on the shelves if

Carmela was willing to pay $1,500 more in promotion fees. Carla points out that $4,500 is a considerable investment for a small company, and the "pay out period" for small product lines is significantly extended.

In addition, my produce industry constituents have expressed their concerns to my office that produce companies are being asked by some retailers to pay flat fees apart from the invoice costs just to continue to do business. They have told me that traditionally these rebates and allowances were tied to promotions, advertising and sampling programs, while today they are more likely to be flat fees unrelated to any incentives or performance.

I understand that the historical purpose of slotting fees was to serve as an adjustment for the grocery retail marketplace for the scarcity of shelf space and the proliferation of new products with high failure rates. However, I do have concerns that this practice may lead to denial of access to markets for small mom-and-pop manufacturers and producers.

A significant obstacle to understanding the impact of slotting allowances on competition remains the lack of information available to government and academic researchers. Simply put, we need more information to determine the impact of slotting fees on competitiveness and consumer prices. I am disappointed that the GAO will testify today that it could not obtain the cooperation of the grocery industry, and so was unable to complete a study of industry slotting practices.

I am hopeful that the Federal Trade Commission's and Department of Agriculture's ongoing investigation of slotting practices will provide Congress with more substantial information. I look forward to learning of the witness's testimony today, and would like to thank Chairman Bond for conducting this hearing, and providing me with this opportunity to submit testimony.

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